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Inge Nickerson, Barry University

Charles Rarick, Barry University

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LETTER FROM THE EDITORS

Welcome to the *Journal of the International Academy for Case Studies, Special Instructors' Edition*. The International Academy for Case Studies is an affiliate of the Allied Academies, Inc., a non profit association of scholars whose purpose is to encourage and support the advancement and exchange of knowledge, understanding and teaching throughout the world. The purpose of the IACS is to encourage the development and use of cases and the case method of teaching throughout higher education. The *JACS* is a principal vehicle for achieving the objectives of both organizations. The editorial mission of this journal is to publish cases in a wide variety of disciplines which are of educational, pedagogic, and practical value to educators.

The Instructors' Notes contained in this volume have been double blind refereed with their corresponding cases. Each case for which there is an Instructors' Note contained herein has been previously published in an issue of the *Journal of the International Academy for Case Studies*. Each case was required to have a complete teaching note before consideration. The acceptance rate for manuscripts in this issue, 25%, conforms to our editorial policies. This publication also conforms to the AACSB requirements to publish case notes which are considered by that body to be of more academic value than the case itself.

If any reader is interested in obtaining a case, an instructor's note, permission to publish, or any other information about a case, the reader should correspond directly with the author(s) of the case.

The Academy intends to foster a supportive, mentoring effort on the part of the referees which will result in encouraging and supporting writers. We welcome different viewpoints because in differences we find learning; in differences we develop understanding; in differences we gain knowledge and in differences we develop the discipline into a more comprehensive, less esoteric, and dynamic metier.

The Editorial Policy, background and history of the organization, and calls for conferences are published on our web site. In addition, we keep the web site updated with the latest activities of the organization. Please visit our site and know that we welcome hearing from you at any time.

Inge Nickerson, Barry University
Charles Rarick, Barry University

CASE NOTES

JOJA'S DELI: GREAT FRANCHISE OPPORTUNITY? (PART II)

Shelley Morrisette, Shippensburg University
Louise Hatfield, Shippensburg University

CASE DESCRIPTION

The subject matter of this case addresses the problems and opportunities for a young family wanting to become entrepreneurs. This case would be most appropriate for undergraduate courses in entrepreneurship, small business management, franchise management, and strategic management, as a written assignment—and graduate courses as a class discussion. The case is designed to be discussed in one to one and one-half hours and should take students no more than three hours of outside preparation.

CASE SYNOPSIS

This case follows a young couple making their first attempt at becoming franchisees, and the inherent risks and challenges of being a small business owner. It also illustrates the difficulties of finding the right “fit” for any budding entrepreneur.

INSTRUCTORS' NOTES

Case Questions

This case depicts the problems and opportunities for individuals on both sides of the franchise business. This situation is like choreographing a ballet. The Baylors represent a young couple making their first attempt at becoming franchisees (i.e., small business owners). At first blush their main problem is typical of many would-be entrepreneurs --- under capitalization. Yet, they are facing many more subtle problems as well.

The individuals in this case are real, but their names, locations, and other trivial facts have been changed to protect their identity. The facts of the case and the financial information are accurate. Some information has been factored up or down to keep critical facts secret, but the relative information has been accurately maintained.

1. Is JoJa's a good "fit" for the Baylors? Why or why not?

Initially, JoJa's appears to be the perfect opportunity for the Baylors. It fits their desired business characteristics perfectly --- right hours, right location, right concept, and they are "close" on the investment issues. But there are several underlying problems that the Baylors have not considered. First, they have never managed a sandwich shop. Even with a relatively straightforward business like a JoJa's, the owner/manager needs "50,000 chunks of information" to be successful. The Baylors have no experience or know-how in this area --- which will make their store operations much more risky. Next, the JoJa franchise does not have much in the way of operational or field support (not to mention marketing, advertising, or promotional support). All franchisees feel that the Levin brothers have done an excellent job of documenting and organizing the materials to launch a JoJa's, but all also agree that more field and operational support is needed. This lack of corporate support reinforces the Baylors lack of experience and increases the risk of franchise operations. Next, the Baylors must develop or hire a complete set of needed skills. For example, they must be able to sell their lunch catering business to corporations. They must also become familiar with the gift basket business and how to market these products. Finally, the Baylors are under-capitalized. They do not have enough capital to launch the franchise (i.e., a "super" deli) and cannot afford the franchise fee at this time. The upshot of this situation is that they are beginning the business in a very risky situation. A few mistakes or just poor business circumstances could doom this operation. Additionally, 25% of all franchised JoJa's have not been successful, which could force the Baylors into bankruptcy. This situation is far from a slam-dunk opportunity for the Baylors even though it "fits" desired business requirements.

2. What would you do if you were the Baylors?

The Baylors have many, many issues to deal with, but only two huge obstacles --- lack of experience and lack of capital. Both of these obstacles must be dealt with if they are to have any chance of success. The issue of capital is most immediate --- without more funding they will not be able to open the store. The biggest issue is the franchise fee. Using the "informal" franchisee communication system, the Baylors have been able to find out that the Levin brothers have not been able to charge any of the seven franchisees (eight units) the stated \$35,000 fee. Most have paid around \$15,000. Thus, they must determine what the franchise will cost. They have plenty of leverage. First, they will be the first out-of-state JoJa's. Next, they will be completely responsible for building the brand outside of the current state boundaries. Finally, corporate support will be non-existent because they will be 600 miles away from the Levin's headquarters.

Once the franchise fee is established the Baylors need to raise enough capital to pay this fee and meet the other operating needs. For example, if both sides agree on a \$15,000 franchise fee, the Baylors will need to raise \$135,000 at a minimum (i.e., \$120,000 start-up costs plus the \$15,000 franchise fee). Naturally, additional working capital is a smart move. Because the Baylors have access to \$110,000 they need to raise an additional \$25,000, at minimum. It is doubtful that they can borrow the money from a bank. They might be able to get a SBA loan, but that will take at least a year. The best thing might be to get a loan from either family or friends. Another option might be to ask the Levins for a \$25,000 loan. But that is an unlikely source for the capital. The important thing is the Baylors need to raise an additional \$25,000 --- it isn't that much money and should not be a deal breaker even if they must borrow two or three times as much. Even if the Baylors must continue to keep their current positions at USAir for a while, or if one of them remains at their current position while their spouse establishes their JoJa's --- any financing solution is worth investigating.

Another option is for the Baylors to open a stand-alone JoJa's. This start-up cost is \$100,000 and the franchise fee would be around \$10,000, so this type of deli is currently within the Baylor's budget. The problem is that a stand-alone unit cannot offer the owners as many revenue streams. The stand-alone units are smaller and do not offer gift baskets or novelty sales. This could decrease store revenues by 20%. In this case, it is probably better to "think big" rather than "small", but it is an option to consider.

The lack experience obstacle is easier to solve. The Baylors should make an on-site training program part of the franchise deal. This would require the Levins to establish a training program at either of the Levin owned JoJa's. If one or even both Baylors could work at a JoJa's for two or three weeks (i.e., unpaid) this would help fill-in many of the holes in their experience levels. Working with Joey or Steve Levin would allow the Baylors to gain a more complete understanding of how one operates at JoJa's and go a long way to ensuring their success. Also, it would allow the Baylors to develop needed skills (i.e., sales, marketing, administrative, etc.) and pinpoint what skills they must hire. It will also establish a "link" between the home office and the franchisee. This type of relationship is very important and can only help both sides.

3. What do you think of the JoJa's concept as a franchise opportunity? What would you do to improve the concept?

JoJa's is a first class franchise opportunity. First, the Levins have established a business that relies on a best-cost provider strategy --- it gives customers (and franchisees) more value for the money. A JoJa's deli creates the highest quality products. The food has won numerous awards and is considered a great value. Thus, JoJa's delivers superior value by satisfying

customer expectations on key quality/service/features/performance attributes while beating their expectations on price. JoJa's has done this by incorporating attractive attributes at much lower prices than their chief rivals. For example, JoJa's sandwiches are the highest quality --- comparable to Panera's Bread, but at almost half the cost. Although their food is somewhat more expensive than Subway's or other sub shops, the taste and quality is far superior. Because this is a hybrid strategy, JoJa's must target value-conscious customers --- which is a very sizable part of the business lunch market. These customers tend to be sensitive to price and value. The only risk is that JoJa's target market becomes squeezed between options that provide lower cost products (i.e., bringing lunch or Subway Sandwiches) or highly differentiated rivals (i.e., Panera's Bread).

Because of this strategy, JoJa's is able to offer their franchisees the same best-cost provider strategy. A JoJa's franchise is relatively cheap and the product (i.e., the service delivery system) is first rate. The franchise provides many things that franchisees are looking for --- high profits, efficient operations, multiple streams of income, short operation schedule, significant margins, easy to reach customers, and moderate growth. Thus, the JoJa concept has a significant competitive advantage over its retail and franchise rivals.

Beyond the competitive benefits of the franchise, JoJa's offers its franchisees significant returns on investment. The investment payback on most units is one year, if you do not factor in management salaries. This is a remarkably short payback period. Two of the franchisees are receiving over \$200,000 each in yearly cash flow (i.e., management salary and profits). This is remarkable return on less than an \$110,000 investment.

Yet, there are problems with the franchise. The greatest problem is the lack of corporate and operational support. The Levin brothers seldom visit franchised units. Thus, there is a lack of control over operations. The franchise agreement entitles the Levins to "control" operations, but the brother's natural tendency is to "keep out of the way". Because most JoJa franchisees are first-time business owners, problems arise. Such things as, failure to provide a complete menu at some units, poor quality control, and irregular hours of operation, are some of the biggest franchisee infractions. The Levin brothers must begin to "control" the franchisees more closely.

All-in-all JoJa's appears to be a great deal for the Baylors. It is doubtful that they will find an opportunity that meets their needs as well as the JoJa's concept. Yet to increase their chance of success they need to work through the two important issues raised in this case --- lack of capital and experience. If these two issues can be addressed, there is no reason to believe that the Baylors will not be successful given their talents and energies.

BLUEGRASS WEDDING CENTER

Richard C. Becherer, The University of Tennessee at Chattanooga

J. Howard Finch, Florida Gulf Coast University

Marilyn M. Helms, Dalton State College

CASE DESCRIPTION

The primary subject matter of this case is the formation of a comprehensive wedding center in Kentucky. The case is positioned to present the business formation process and the search for partners and financing for a new business venture. It also involves turning a number of fragmented product and service providers in the wedding industry into a one-stop center, representing a new product/service combination. More specifically, the case deals with the human issues and challenges in selecting among a number of disparate partners and determining their potential equity stake, investment, and obtaining funding for the business.

Secondary issues examined in the case include assessing the new venture idea based upon actual narrative among the potential founders and excerpts from their business plan. Students should be able to directly identify with the wedding industry and the young couple in the case. Family business challenges also emerge into the case and the owners struggle to make the decisions necessary to turn their business idea into a reality.

The case has a difficulty level of two or three, and is best utilized in a junior or senior-level entrepreneurship, small business, strategic management, marketing of services or product/service development course. This case is very appropriate for undergraduate courses as: 1) students can relate to this industry, 2) the human issues demonstrate the challenges involved in starting a business, 3) and the financial analysis is fundamental and straightforward. It is an excellent case for in-class discussion in a 50 to 75-minute class period and should include debate of alternative issues, particularly when parts B and C of the case (included) are used to follow-up on the main case decisions and actions in the following class meeting. It lends itself to role-playing of the key participants involved, particularly the discussion with the various potential partners over options for structuring the business. The case requires two hours of preparation.

CASE SYNOPSIS

Julie had long dreamed of starting a wedding center. In her business plan, she wrote: "Anchored by an attractive wedding chapel capable of seating 350 people, the complex will include retail shops that offer floral, catering, dresses and tuxes, photography and video, accessories and possibly even a travel agency, beauty salon and jeweler. To complete the offerings, a large

expandable reception hall with a complete commercial kitchen and bar will allow the complex to provide every need associated with a complete wedding. Landscaping will be designed to accommodate outdoor weddings, as well as, create a garden setting to the surroundings.” With her husband’s support and the help of his entrepreneurship professor and her wedding planning colleagues, her dream might become a reality.

This case involves a couple’s efforts to turn a home-based wedding planning business into a one-stop shopping center offering customers every aspect needed for a complete wedding event. It represents an effort by a recent business graduate to take a business plan developed in an entrepreneurship course from a class project to reality. The proposed center will include wedding planning services, dresses and formal wear, photography, florist and catering services, as well as a wedding chapel and reception facilities. By offering customers the opportunity for one-stop shopping for their wedding, the involved businesses should have a competitive advantage over established concerns that only offer individual components. The case provides a first-hand account of the excitement and frustrations involved in developing an entrepreneurial idea and obtaining financing to turn the dream into an actual business venture.

Careful discussion of the case should enable the business students to better understand (1) structuring the “deal” for a new venture, (2) weighing the pros and cons of both debt and equity financing, (3) vertically and horizontally integrating a fragmented industry, (4) searching for appropriate and acceptable venture partners, (5) personality challenges in running a family business, (6) the personal decisions involved in starting a business, (7) analyzing market potential and assessing a new business venture, and (8) understanding the consequences of poor credit and the importance of conducting due diligence on all potential acquisitions.

INSTRUCTORS’ NOTES

Recommendations for Teaching Approaches

This case is an actual experience that evolved in the graduate entrepreneurship class of the first author. The husband was enrolled in the class, and he used the class business plan requirement to develop his wife’s idea of a one-stop wedding center that offers clients the entire range of products needed to conduct a full wedding event. The couple then met with the first author to seek advice based on his own entrepreneurial experience as to how to proceed turning the idea into a reality. They continued to rely on him for outside advice as they worked with the various parties detailed in the case to obtain financing for the venture. The second and third authors have also been involved as a sounding board when the first author wished to relate their problems and concerns throughout the process.

The focus of this case involves the trials and tribulations that the couple faces in trying to finance their business idea. The case highlights both qualitative and quantitative issues that arise as the search for funding unfolds. Qualitatively, the couple experiences both emotional and personal

financial stress, as they grapple over the risk and return consequences associated with the various funding alternatives they consider. Quantitatively, they face the classic entrepreneur's dilemma of how much of the firm they should give up to outside financing interests. This conundrum of how much ownership and control to exchange for necessary start-up and working capital to turn the idea into a reality is one all those who use and study the case will appreciate.

Since the case involves the couple's actual experiences, the focus of the case was obvious. Nevertheless, all students of entrepreneurship should have to face the fact that the risk-reward trade-off includes having to decide how much of their firm they are willing to sell. In addition, the search for capital funding often involves having to consider going into business with outside, unfamiliar associates. The case shows the couple considering everything from using personal debt to conventional lenders, as well as seeking equity investment from both known business associates and an unfamiliar angel investor. The range of potential capital investors, together with the emotional toil that each source exacts on the couple, will provide users of the case with a realistic insight into their actual experience trying to make the business plan work.

Since Chad was a student of the first and second author, and sought the advice of the first author due to his extensive entrepreneurial experience, it was easy to obtain a first-person account. In addition to making notes and keeping records as the process unfolded, the couple agreed to provide an oral narrative of their experience at its conclusion. Thus, the case information was obtained directly through a series of oral interviews that were tape recorded and transcribed. The numerical data was standardized and adjusted to provide for cleaner financial analysis for students, and the names and entities were changed to provide anonymity.

This case is appropriate for the following courses: entrepreneurship, small business, strategic management, marketing of services, or product/service development. This case is appropriate for undergraduate courses as: 1) students can relate to this industry, 2) the human issues demonstrate the challenges involved in starting a business, 3) and the financial analysis is fundamental and straightforward.

It is an excellent case for in-class discussion and debate of alternative issues, particularly when parts B and C of the case are used to follow-up on the main case decisions and actions. It lends itself to role-playing of the key participants involved. For a marketing class and even a strategic management class, students may also be assigned the task of interviewing wedding planners, consultants, or other service providers in the local wedding planning market to update and augment the current industry situation.

With role playing or similar in depth discussion, the case (Part A) can be effectively covered in 45 to 60 minutes and parts (B) and (C) should require 15-30 minutes each. As a class quiz or part of a case exam, students can use the financial information provided to perform for cash flow, break-even, and ratio computations. The experience and interest level among students regarding this industry allows the case to be assigned as a presentation by student teams. The case can be used for a continuing education audience of potential entrepreneurs as they prepare the business plan and

consider the various decision points in the early stages of a business venture. Speakers from the wedding planning and services industry can also be used as outside speakers to provide additional background and updates on the industry and the feasibility of such a on-stop-shop in various locations around the U.S. and internationally.

Since the case was originally an idea that developed from an entrepreneurship class, the case will be of interest to students working to develop their own business idea and drafting a feasibility study or business plan. Students should also identify with the varying personalities and pros and cons of the various financial arrangements that are presented.

The instructor can open the discussion by taking a poll regarding the decision to take money out of the couple's 401K to keep this business idea alive. Students are often divided on this question and it leads to a discussion of the opportunity presented by this business idea and the ability of this couple to be successful.

After exploring the dynamics of the couple's relationship and the decisions they have to make in order to go forward, the business plan and industry data provided in the case can lead to an assessment of the opportunity. Students often have strong opinions regarding this business concept and how well it meets the needs of prospective brides and grooms. Additionally, enough financial information is provided to evaluate a basic pro forma income statement and analyze the ability of the business to handle the debt associated with the SBA bank loan.

Generally, as discussion regarding issues in the main case begins to wane, or in a subsequent class session, the instructor can stimulate more discussion by passing out Cases B and C. Case B focuses discussion on partner issues, and how an entrepreneur reacts to set backs. Case C shifts the discussion to all aspects of negotiating a deal.

The following questions might be used to focus the class discussion.

1. How crazy is this idea? Does it make sense to involve these other "partners"?
2. Should Julie and Chad pull money out of their 401K to go through with this? What other sources of funds should be considered?
3. Should Julie continue to push and tap her resources?
4. Now that your partners have pulled the rug out from under you by structuring another deal, do you reject their offer or do you consider that now you can at least become an entrepreneur and own a piece of a business? Is a piece of a business better than nothing?
5. What kind of a deal would you structure? What would you ask for? How much equity stake would you give Mr. Baxter? Board representation? Is this the kind of person you want to get into a deal with? What are the risks and downsides of the new partner? What should you guard against as you structure the deal, particularly the equity stake and roles and responsibilities?

-
6. Using the pro-forma balance sheet, calculate the current ratio and the quick ratio for BWC, and comment on the firm's projected liquidity. What is the difference in these calculations, and which ratio is more useful for liquidity assessment?
 7. Using the pro-forma balance sheet and income statement, calculate the long-term debt ratio, the debt to equity ratio, and the times interest earned ratio for BWC. Comment on the firm's leverage and ability to handle the debt service associated with the SBA loan.

The process of forming a business, searching for partners, and arranging financing is the subject of this entrepreneurial case of a young couple's dream to open a one-stop, full-service wedding center for today's busy bride and groom. The center will house a travel agent, bridal salon, chapel, area for receptions, and a host of other related services in one location. The couple begins the process by working with a number of businesses and service providers as they plan the business. Teaching objectives include: (1) explore the human aspect of entrepreneurship, working with business partners, investors, spouses, and friends and family members. How to balance ideas and input from others in leading an entrepreneurial effort, (2) provide an opportunity to perform a venture evaluation, with excerpts of the business plan integrated with dialogue between the founders and potential partners combined with information about the local market and the wedding industry, (3) To practice the skills of assessing a business plan, idea, and capital structure, (4) Understand various ways to structure and finance a new venture, and (5) Analyzing the profitability of a business using industry data, initial balance sheet information, and projected income statements for the initial start-up period (review cash flow, break-even, and ratio analysis of liquidity, leverage, profitability, and turnover).

DISCUSSION QUESTIONS FOR PART A

1. **Assess the business plan. As an investor, what would you want to know before investing?**

While the parts of the business plan included in the case include a good profile of the current industry and local market, potential investors would need additional information on who specifically is going to manage the operation and they need more information about their background. We are only given information on Julie and Chad. What will Chad's role be? Will he quit his job at GE and become involved in the business? If so, when? These questions need to be asked by potential investors. The opportunity side of the venture is good but more information on the team is required prior to investors providing financial resources.

Most inventors would want to get to know Julie to see if she has the experience and work ethic to make this concept work. In most businesses, the entrepreneurial team makes

the biggest difference between success and failure, and while this business has a small team, it has a leader that can make a huge difference.

Additionally, investors will want to know more about how the Bridal Center will be marketed. Beyond the bridal shows, how do brides find out about this type of bridal alternative? Special promotions that generate publicity for the business will be a critical part of the marketing plan, as well as, the traditional advertising mediums.

2. How crazy is this idea? Does it make sense to involve these other “partners”?

While the market and industry seem promising and profitable with new emerging markets and services, this venture lends itself to discussion as to the fit for the couple involved. They will jeopardize their personal marital relationship, family finances – both current and possible retirement funds – and experience problems working with friends and family for financing. Should the venture fail, the couple will have a tarnished credit rating and no savings from which to rebuild. The stress of starting a business is also showing signs of being a real problem for the husband and children due to the initial time demands to plan the business while continuing to serve as a wedding consultant on weekends.

Julie is to be commended for attempting to put an entrepreneurial team together. This is critical in creating businesses that have a real chance for success and harvest potential. Unfortunately teams of entrepreneurs can have personality issues. The key thing to move toward in class discussion is that entrepreneurial teams only have to work together and respect one another through harvest. Julie may not have been careful enough in choosing people to join her in this new venture team. (For more information, see Reich, 1992).

3. Should Julie pull money out of their 401K to go thru with this? What other sources of funds should she consider?

While it is often difficult to find start-up funds, many are forced to exploit “friends, family or fools.” When these three groups are not supportive or don’t have financial means, principals are forced to use personal savings or credit card debt to start a business. When personal savings are largely 401K retirement monies targeted for future income needs post age 65, it is realistic to question the use of these funds. Should the business fail or if the funds are not enough to launch an effective start-up, the couple will be left with few current funds and be disadvantaged for retirement. In addition, with three small children, college savings funds are as equally important as are their retirement funds to the household. And yet, how do prospective entrepreneurs come up with the money they need to start a business if they do not take risks?

Entrepreneurs first source of funds are often friends and family. The advantage of this approach is that funds may be available more quickly with less documentation required. On the other hand, friends and family represent long-term relationships that could be compromised if the business does not perform as expected. A bankrupt business can dramatically impact on family gatherings far into the future. This type of venture will not generate enough return on investment to attract angels or venture capitalists.

Entrepreneurs often finance their venture by selling assets such as their classic car, boat, or vacation property. While the enjoyment of these things will be missed, the worst-case scenario does not interrupt long-term relationships. While second mortgages or credit card cash advances can also serve as a start up capital, the pay back may adversely affect the cash flow of a struggling business. (For more information see Timmons and Sander, 1997, or Stancill, 1992).

4. Should Julie continue to push and tap her resources?

While the business plan seems sound and the industry well researched, continuing to push has already alienated friends and family who seem to be refusing or dodging phone calls from Julie. In addition to the discussion in Question 3 above, continuing to tap all the family's resources is a risky short-term decision, which could jeopardize the business now, and in the future as well. Bankruptcies and tarnished credit ratings are hard to recover from, and make future business ventures very difficult. A wait-and-plan strategy is probably more feasible than tapping all family and financial resources at the current time. Chad's role as "devil's advocate" seems to bear this out and is a good sounding board to Julie's emotional responses to the business idea and formation process.

On the other hand, commitment, determination, and an "opportunity obsession" have all been cited as factors in entrepreneurial success. Pushing through problems is often part of the entrepreneurial process. It's important to recognize that Julie's enthusiasm is often one of the most important ingredients in a new business start-up.

5. Use the pro-forma financial statements; calculate the current ratio and the quick ratio for BWC, and comment on the firm's projected liquidity. Then calculate the long-term debt ratio, the debt to equity ratio, and the times interest earned ratios for BWC. Comment on the firm's leverage and ability to handle the debt service associated with the SBA loan.

Current ratio = current assets/current liabilities = 1,010,806/411,000 = 2.46.

Quick ratio = (current assets – inventory)/current liabilities = (1,010,806 – 616,000)/411,000 = .96.

The current ratio indicates the firm has a high ability to meet short-term liability obligations; however, when you deduct inventory, the picture changes dramatically. It appears the firm is planning to carry a rather high amount of illiquid inventory, and when this is taken into account in the quick ratio liquidity diminishes rapidly. This indicates the firm may need access to a bank line of credit, or additional working capital sources, to avoid a cash flow crisis.

Debt ratio = total debt/total assets = $1,411,000/1,805,806 = .78$ for every \$1 in assets, the firm expects to borrow \$0.78 to finance them.

Debt/equity ratio = total debt/shareholders equity = $1,411,000/394,806 = 3.57$.

The firm plans to borrow \$3.57 for every \$1 in shareholders equity invested.

TIE = EBIT/Interest expense (first year) = $(263,544+110,000)/110,000 = 3.40$.

During the first year of operations, the firm expects to earn \$3.40 for each \$1 of interest expense it must pay. BWC will be a heavily financed business. The firm expects to be over 75% debt financed; however, the first year P&L indicates the firm expects to easily be able to service the interest expense associated with the \$1 million SBA loan.

QUESTION FOR PART B

6. **Now your partners have pulled the rug out from under you by structuring another deal, do you reject their offer or do you consider that now you can at least become an entrepreneur and own a piece? Is a piece of a business better than nothing?**

Julie is understandably angered by what seems like her friend's betrayal of her and her business idea. But upon reflection, this does represent a way for Julie to have her business and be the entrepreneur she dreams of being. Often entrepreneurs have to get started in a manner that is less desirable they had hoped. By getting additional experience, further developing their networks, and gaining a track record, however, the less than satisfying start-up can often lead to bigger and better things. One might question the values and integrity of the two sisters as potential business partners, however.

It is important for an entrepreneur to have enough motivation to overcome these types of problems, and creatively come up with new solutions. Often entrepreneurs are too emotional about setbacks or take it personally. Entrepreneurs need to stay focused and go to plan B before they lose too much momentum or miss their window of opportunity. (For more information see Kets de Vries, 1985).

QUESTION FOR PART C

- 7. What kind of a deal would you structure? What would you ask for? How much equity stake would you give him? Board representation? Is this the kind of person you want to get into a deal with? What are the risks and downsides of the new partner? What should you guard against as you structure the deal, particularly the equity stake and roles and responsibilities?**

Students may have a number of suggestions about how to proceed and the percentage of ownership and equity in the business. The board needs to be composed of industry experts, if possible, as well as other entrepreneurs further along in the self-employment process to best guide the couple. As to the kind of person to work with, at this point the business most needs start-up funding. A silent or almost-silent partner with money is critical, particularly if the investor brings with them a network of business connections. While Chad and Julie need enough free rein to do what they know best, an investor can be valuable as a sage advisor.

One thing for Julie to remember is that entrepreneurship is not a solo event. She has not been able to pull the resources together on her own, and she might not be able to do it at all without giving up some equity. If this venture is successful, the rewards associated with half of the ownership will be well worth the effort and risk.

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NOTE

Note: for an updated Epilogue of the case, please e-mail either Dr. Richard Becherer (Richard-becherer@utc.edu), Dr. J. Howard Finch (jhfinch@fgcu.edu), or Dr. Marilyn Helms (Mhelms@daltonstate.edu).

E. M. MAPALAD AND THE MAPALAD BUS LINERS, INC.: THE BUSINESS ENDED DESPITE A TALENTED ENTREPRENEUR

Maria Claret M. Ruane, Alfred University

Amy Rummel, Alfred University

CASE DESCRIPTION

The primary subject matter of this case is entrepreneurship. Secondary issues examined in the case include strategies involved in family business startup, growth, and decline, including profit-maximizing strategies (revenue maximization in particular), as well as international business environments and their impact on businesses, in general, and family businesses, in particular. This case has a difficulty level of three and up, appropriate for junior level and beyond. The case is designed to be taught in two to three class hours in a management or an entrepreneurship or international business course, and is expected to require about three hours of outside preparation for students, consisting mainly of reading the case and familiarizing themselves with the business implications of a Martial Law regime.

CASE SYNOPSIS

The case is about Eustacio Marino Mapalad, an entrepreneur, and the successful transportation business he created in the Philippines after World War II and operated for more than 50 years. The case traces through the history of his business, from its beginning as a surplus U.S. Army jeep that was leftover from the war to a fleet of thirty five full-sized buses at its peak in 1965-1972. In doing so, the case illustrates an example of how a highly motivated and very talented entrepreneur started his businesses from limited resources, and how his skillful management of these and additional resources and his ability to identify and pursue opportunities made him the number one bus operator in Manila twenty years after he started his business. The case also shows how a drastic change in the political environment adversely affected his businesses and drove this once motivated, dedicated and successful entrepreneur to give up on the business that he created.

This case secondarily provides a glimpse of the transportation industry in the Philippines between 1945 and the 1980s for which no explicit study exists and for which data are generally not available. It also gives a personal account of the political, economic and cultural environments faced by the entrepreneur and how these environments affected a number of his major business decisions.

INSTRUCTORS' NOTES

Discussion Questions and Guide

1. **Conduct an environmental analysis of this case. Initially, what factors aided Mapalad in the growth and success of his business?**

There are 5 “environments” which affect any business strategy. They are:

- ◆ Political and Legal
- ◆ Economic Environment
- ◆ Social and Cultural
- ◆ Technological
- ◆ Competitive

Political and Legal

Political and Legal environments are naturally intertwined because changes in the political environment most often lead to changes in the legal environment.

Initially, the political climate in the Philippines after WWII was extremely supportive to entrepreneurial activities. After independence in 1946 the Philippines had access to free trade with United States. Meanwhile import restriction facilitated manufacturing within the Philippines. These factors led to an entrepreneurial spirit in this country and growth in business sector. People like Mr. Mapalad to initiate his own business, dependent upon the business sector growth.

Economic Environment

As identified previously, due to changes in the political and legal environment, the economic environment proved itself beneficial for the growth of new businesses. Mr. Mapalad was well positioned. Initially, his ability to secure a route servicing a route catering to the U.S. Military was critical. As the Filipino market developed economically, Mapalad’s business was able to thrive.

Social and Cultural

The key factor for success in this environment was the lack of a “car in every driveway” – a key cultural phenomenon in the American culture in 1950s. Filipinos were

open to and therefore depend upon public transportation in the capital of Manila. For Mr. Mapalad this insured a demand for his services

Technological

Access to transportation post WWII was limited. As identified in the case, Mapalad's first mode of transportation was a refurbished army jeep. Access to other forms of transportation was extremely limited at this time. In this case, it could be said that restrictions placed on technology provided a strategic opportunity. Lack of adequate infrastructure (road quality and maintenance) proved the "jeepney" to be the best form of transportation.

Competitive Environment

Lack of competition was a key factor for success for Mr. Mapalad. Initially, demand for Mapalad's route to and from the U.S. military base was high enough to support multiple suppliers. He also was able to differentiate himself from his competitors based on his reputation and reliability.

When Mr. Mapalad moved his business to Manila and expanded to a fleet of 10 buses, he was able to secure a 25-year franchise for the PUB routes in Manila. This was an extremely effective method of protecting his business from any competitor.

It could also be noted that Mr. Mapalad initiated certain marketing activities to protect him from his potential competitors. Through the use of branding (painting his buses and banding them with E. M.), he was able to build visually on his reputation to create brand equity.

2. What were Mr. Mapalad's key factors for success?

There were many key factors for success. Some that should be discussed are:

- ◆ Personal Expertise
- ◆ Human Resources
- ◆ Adaptability to change
- ◆ Financial Credibility

Personal Expertise

In the famous article "Stick to your knitting" Porter identifies that a key factor for success is as business personal expertise in their field. Mapalad build a solid business on his knowledge base-driving experience (ambulance services to and from battlefields) and

mechanical. He came to build his financial success on his reputation which was due in large part to the reliability of his transportation services. This could only be achieved because he knew how to keep his vehicles operational: stocking parts for repair, installation of diesel engines to reduce costs were just some to the business activities employed.

Human Resource Management

Initially, Mapalad employed family members in the expansion of his business. This was a benefit to him because he was able to trust his employees because of his personal relationship with them. As his business grew, it was necessary to hire drivers outside his family. As with his family, he focused on fair compensation for his employees not only in terms of wages but in the number of hours he provided for each worker. Ethical treatment of his employees coupled with maximum reimbursement allowed him “to attract (and retain) the most talented personnel” (pg. 6).

Adaptability to Change

Throughout the evolution of Mapalad’s business, he adapted to environmental changes. From seizing the transportation opportunity initially, to expanding and moving his services to Manila, to finally franchising a 10 bus route, reflects Mapalad’s ability to change with new opportunities. From 1963 to 1972, when he had 35 PUBs, Mapalad grew his business under positive economic and political conditions.

Financial Credibility

Another important factor in the success of this business was Mapalad’s financial stability and credibility. Starting with only his personal earnings, he was able to parlay his income into the eventual “Mapalad Liners” of 35 PUBs. For example, he used 300 Php of his personal savings to purchase his first surplus jeep, which he converted into a passenger jeepney. Also, from a combination of his savings and profit, he was able to purchase a lot, half of which he used as his home and office-garage for his 5 jeepneys while the other half was rented out to pay for his mortgage.

He also became very adept at building his business and personal assets to use as collateral for each new expansion of his business. Initially, as identified in the case, Mr. Mapalad used his profits to buy his own vehicle. On his profitability from this business he then was able to buy a lot, which he used both for his business and his home. Through combining his personal and business finances, he was able to reduce his overall costs, which

increased his overall profitability and net worth. Hence, as his new businesses grew, so did his financial strength and credibility with his lenders.

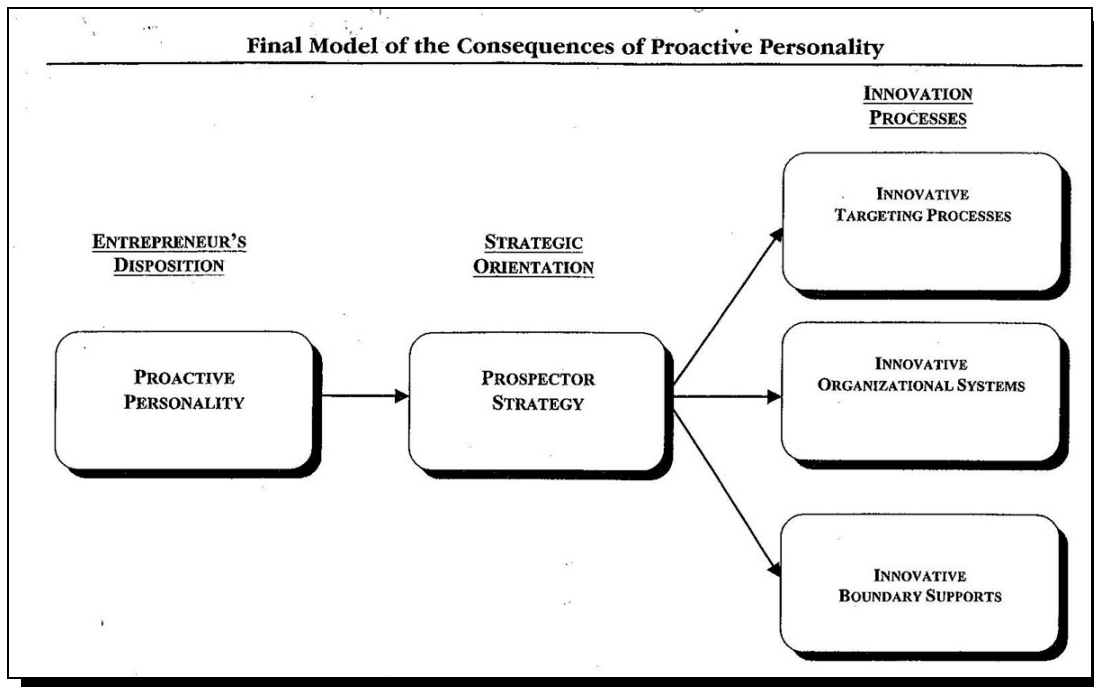
3. In what ways did Mr. Mapalad display characteristics of an entrepreneur?

Bateman and Crant (1993) identified “proactive personalities” as being one of the defining personality characteristics that entrepreneurs have. They define this characteristic as the ability and proclivity to “scan for opportunities, show initiative, take action and persevere until they reach closure by bringing about change.” (pg.105). Mr. Mapalad displayed such a personality characteristic throughout his business career. At each juncture he identified an opportunity and was able to develop a business venture to meet a unique or developing need in the market place. His ability to be flexible and “change in response to surrounding business conditions” (Kickul and Gundry, 2002, pg. 93) was entrepreneurial and critical in the business environment he was functioning in, that of a developing country post WW II. Additionally he was able to create value by combining resources to exploit an opportunity, another key factor in defining an entrepreneur (Christensen, Masden and Person, 1989; Koller, 1988; Kickul and Gundry ,2002). See Model of the Consequences of Proactive Personality)

Another characteristic identified in the entrepreneurship literature is a business owner’s strategic orientation being that of a “prospector” (Miles and Stone, 1978). This orientation is the ability to continually scan the environment for new opportunities in terms of product, service and/or technology. Mr. Mapalad was able to look for creative ways of developing brand awareness (business signage), create efficiencies (bus scheduling, payment of debt, allocation of resources both physical and human resources) and target new markets (monopolistic ownership of bus routes) to name a few.

4. What factors led to the eventual downfall of Mapalad’s business?

In spite of Mr. Mapalad’s efforts, his business failed. The largest contributing factor that led to his downfall was the changing political environment. With the establishment of the Marco’s dictatorship, there was really no possibility for survival. Some analysts might even suggest that it was Mapalad’s success that made him prime for destruction. Under the political regime, Marcos was able to identify any business for state ownership. Those businesses that appeared to take money away (i.e., profitable) from the state were certain to become state owned. Mr. Mapalad’s business had no protection from these politics.



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CHICAGO FOOD AND BEVERAGE COMPANY: THE CHALLENGES OF MANAGING INTERNATIONAL ASSIGNMENTS

Virginia Bodolica, University of Quebec in Outaouais
Marie-France Waxin, American University of Sharjah

CASE DESCRIPTION

The primary subject matter of this case concerns the management of expatriate managers with a particular focus on their recruitment and compensation. Secondary issues examined include the internationalization strategies of a multinational company and particularly the alignment of international strategy and headquarters' orientation regarding the international human resource management policy. The case has the difficulty level of six (appropriate for second year graduate level). The case is designed to be taught in three class hours and is expected to require five hours of outside preparation by students.

CASE SYNOPSIS

The Chicago Food and Beverage Company (CFB Co.) is an American multinational with subsidiaries in North America, Europe and Asia. The case is about the alignment of CFB Co. internationalization strategy and the orientation of the head office in regard to its international human resource management (IHRM) policy and management of international assignments, with an emphasis on expatriates' recruitment and compensation. The case describes the international development of the company and the subsequent expatriation of Paul Fierman, the head of the Vietnam subsidiary. Paul's three-year mandate includes the preparation and execution of the strategy to synergize the three Asian subsidiaries (Singapore, Hong Kong, Vietnam) with the collaboration of the head of the Pacific Rim, which should allow CFB Co. to conquer the Asian market. Six months after his arrival, Paul Fierman is disappointed by the financial conditions of his contract and by his relationships with local colleagues, not to mention the difficulties his wife has been having adapting to this new environment. The discussion of this case in class allows introducing and illustrating the theoretical concepts related to the following topics: 1) internationalization strategies and international human resource management policies; 2) strategic management of international postings; and 3) advantages and disadvantages of different international compensation methods.

INSTRUCTORS' NOTES

Teaching Objectives

This case allows the introduction and illustration of theoretical concepts which are related both to internationalization strategies and to the management of international staff.

This case can be studied under one or many angles: the internationalization strategies, the management of expatriate managers, their recruitment and compensation in particular. The case includes a lot of information and students must classify and use it in order of its relevance.

In Which Programs, in Which Types of Classes

This case was originally written for use in human resource management or international human resource management (IHRM) classes offered in MBA or M.Sc. programs.

We recommend distributing the case one week before the discussion session and asking the students to prepare the case at home, given its length. The discussion of the case in class could easily take three hours.

Sources and Methods of Data Collection

This case is fictitious, although inspired by true events. We based ourselves on observations in many companies, IHRM articles and the subjects broached during interviews with expatriates carried out during our doctoral studies. The data on the Vietnamese context are real and were gathered on different web sites available on the internet.

Links with Which Functions

This case is useful for examining the function of international human resources managers or the functions of expatriate managers in general.

USING THE CASE IN THE CLASSROOM

The professor can begin by indicating the problem of managing international employees in the context of a strategic joint venture of the type used by today's companies.

The professor can also divide the class up and ask each group to examine a different aspect of the problem.

Questions for the Preparation of Students' Discussion in Class

We propose the following themes for discussion:

1. The alignment of international strategy and the headquarters' orientation regarding the IHRM policy;
2. The strategic management of international postings with emphasis on two subjects:
 - 2.1. The filling of international posts;
 - 2.2. The compensation of international managers.

THEME 1: ALIGNMENT OF INTERNATIONAL STRATEGY AND HEADQUARTERS' ORIENTATION REGARDING THE IHRM POLICY

1. Which internationalization strategies do you recognize in this case study?

Organizational characteristics	Multinational	Global	International	Transnational
Configuration of assets and capabilities	Decentralized and nationally self-sufficient	Centralized and globally scaled	Sources of core competencies centralized, others decentralized	Dispersed, interdependent, and specialized
Role of overseas operations	Sensing and exploiting local opportunities	Implementing parent company strategies	Adapting and leveraging parent company competencies	Differentiated contributions by national units to integrated worldwide operations
Development and diffusion of knowledge	Knowledge developed and retained within each unit	Knowledge developed and retained at the centre	Knowledge developed at the centre and transferred to overseas units	Knowledge developed jointly and shared worldwide

Bartlett & Ghoshal (1989) distinguish four types of strategies or international organizational configurations: multidomestic, international, global and transnational (see Table 1). In this case study, after the domestic expansion phase in the United States (1960-1985), we recognize the following internationalization strategies. From 1985 to 1998, each subsidiary maintains a specialized production destined for a domestic market, which corresponds to the multidomestic configuration. Then, in the new, more complex configuration (after 2000), we find multidomestic, global, and

transnational elements. Here, we can also spot the characteristics of the global configuration: certain primary products will be standardized and produced by certain subsidiaries for all the other subsidiaries. Finally, all the subsidiaries will be interdependent and will depend on certain products coming from other subsidiaries, but at the same time they will continue to produce local specialties (we are therefore talking about an integrated structure): these are elements and characteristics of the transnational configuration.

The professor can insist on the fact that we never see a configuration in a pure state, but that we recognize certain tendencies and typical characteristics.

2. What is the HRM orientation adopted by the headquarters? What comments can you make concerning this choice? What can you recommend to the company's headquarters in this sense?

Perlmutter (1969) was the first to distinguish three ways to apprehend HRM in international corporations: ethnocentric, polycentric and geocentric. A fourth way of conceiving HRM policy was subsequently added to these: regiocentric (Dowling et al., 1999).

In this case, we recognize an ethnocentric orientation. HRM in an ethnocentric orientation does not give any decisional autonomy to the subsidiaries, the strategic decisions are taken at headquarters and the subsidiaries are managed by the expatriate employees from headquarters. Also, the head office makes all the important decisions about the management of international postings (recruitment, selection, training, etc.).

The professor can ask students to examine the pertinence of an ethnocentric orientation in the actual situation. In this case, we see that a new structure is being built; the leadership comes from the world headquarters. No regional leadership has yet been developed. However, in the medium and long term, the ethnocentric vision does not correspond with the vision of the integrated structure. The head office should examine the possibility of adopting a regiocentric vision. The American headquarters should begin building regional leadership by further implicating the Asian office in the management of the Asian subsidiaries. In reality, the change from the ethnocentric to the regiocentric perspective is long and hard. The markets in the United States, Europe and Asia are very different, as is the management.

In the context of the regiocentric approach, regional decisions are made in the regions, thereby reflecting the strategy and geographic structure of the multinational. The HRM practices are harmonized in the subsidiaries of a given region. The regional managers benefit from autonomy in decision-making relative to their respective regions. These managers can be promoted in the regional units, but rarely to a post at the world headquarters.

THEME 2: STRATEGIC MANAGEMENT OF INTERNATIONAL POSTINGS

1. **Is Paul Fierman a good candidate for this expatriation position? Here we discuss Paul Fierman's mission, from the description of his position, the profile of the ideal candidate and Paul Fierman's actual profile. Does Paul Fierman correspond with the ideal candidate? What is Paul Fierman's mission?**

Three year mandate, to manage the subsidiary, implement the new organizational strategy (synergizing the three Asian subsidiaries).

What is the profile of the ideal candidate (define the competencies necessary to successfully carry out this mandate)? What is Paul Fierman's profile? (see Table 2).

The profile of the ideal candidate for Paul's position	Paul's actual profile
Good management education	Good management education
Specialist in inter-organizational restructuring	Product head, marketing specialist
International experience	Some international experience: one year as an exchange student at Oxford (always an English-speaking milieu)
Linguistic skills	English as a first language
Knowledge of Asian cultures	-
Adaptability, cultural sensibility	-

2. **What comments can you make on the expatriation management in general? And what comments can you make on the expatriate recruitment policy in particular?**

The strategic management of expatriates includes at least six following steps:

1. Strategic planning of the positions
2. Staffing (job analysis, recruitment, selection, orientation)
3. Orientation/training for the post in relation to the culture of the host country
4. Adaptation to the position and the support policy for international employees
5. Management of performance
6. Management of the repatriation

1. *Strategic planning*: We will have the students note that CFB Co. does not seem to strategically plan its needs and resources in international managers. The replacement of Paul Fierman's predecessor had not been envisaged before it became necessary and no potential candidate had been identified.

2. *Staffing*: We orient the discussion towards the different steps of the process of filling the post: job analysis, recruitment, selection. It is important that the students note the absence of a reflection period by the company on its procedure for filling the post. The methods used to fill the post in the case are indeed quite questionable. The students can examine the three following aspects in detail:

Job analysis: The description of the position and the profile of the competencies sought do not seem to have been laid out professionally.

Recruitment: According to the information given in the case, the company did not formally publish or announce the opening up of the position and made no effort to generate candidacies internally or seek out qualified candidates. In this case, the company uses a close recruitment system (the opening up of new positions and the candidacies are confidential).

Selection: Many errors were made. Firstly, the selection criteria were not determined in a professional manner using a description of the position. Further, CFB Co. did not use any of the formal and valid selection methods (structured meeting, examination of previous evaluations, verification/tests of pertinent international competence and experience, evaluation centre). Finally, the question of the selection of the evaluators should come up. The head of the regional office that best knows the situation of the Haiphong subsidiary should have participated in the selection of the new head manager. The selection process took place in a totally informal manner.

3. *Orientation/ training*. The headquarters is supposed to furnish the future expatriate with precise and useful information about the position to be filled (description of the tasks, the responsibilities, professional challenges), the characteristics of the regional office and its employees and the environment in the host country (local culture, logistical information, practical information on life in the new country). In our case, no useful information was given to Paul before he arrived on the scene. The American and regional offices should have organized a meeting between Paul and his predecessor and verified that Paul met regularly with his superior, who should also have had a role to play as a mentor, at the regional office. Finally, the professional and intercultural training were non-existent.

4. *Adaptation to the position and the support policy for international employees*. The adaptation of expatriates comprises three facets: the adaptation to the work, to the interaction and to local life (Black and Gregersen, 1991). Paul Fierman seems to

be suffering in all three of these aspects. He seems to be caught up in the cultural shock phase, which is quite ordinary, six months after his arrival.

We then discuss the role of the international head office and the regional office in the support policy for international employees. CFB Co. offered Paul no social or professional support, either in relation to his new role as head manager or in relation to the culture of the country of his recent posting (Waxin, 2004 ; Waxin and Chandon, 2003). The fate of Paul's wife and daughter were simply ignored by the company.

5. *Management of performance.* The world headquarters is supposed to set the objectives of the mandate in collaboration with the expatriate manager, or at least clearly explain the methods used to evaluate performance, provide the professional and social support necessary for him to fulfill his mandate and finally to regularly follow the performance of the expatriate. None of these actions were taken in this case.

6. *Repatriation.* The head office is supposed to explain and predict, with the expatriate, the different options relative to the return to the home country. The competences acquired during the expatriation should be taken into account.

THEME 3: THE COMPENSATION OF INTERNATIONAL MANAGERS

The professor can begin by reminding students of the objectives of the compensation policy. For a compensation policy to be effective, it must meet the following objectives:

- ◆ Attract and retain employees who are qualified for work abroad;
- ◆ Establish and maintain internal equity between the employees of all the affiliates, whether in the home country or abroad;
- ◆ Maintain compensation which is reasonable and competitive in relation to the practices of its main competitors (external equity).

Then, the professor focuses on the question of the challenges related to international compensation policy. The context of the globalization of markets poses some important challenges in regards to the management of expatriates' compensation. For the multinational, one of these challenges is the control of the cost of international labour. It is thus crucial for the company to efficiently manage this investment and even more so if it employs a significant number of expatriates. Harvey (1993) cites the following four other challenges:

- ◆ The assurance that there is equity in the compensation of home country, host country and third country nationals;
- ◆ The adaptation of compensation solutions to the variations in the needs of the expatriates in accordance with the level reached in the family cycle;
- ◆ The management of the repatriation;
- ◆ The difficulty in changing an existing compensation system.

1. What are the different expatriate compensation methods you recognised in the text? What are the advantages and disadvantages of these different expatriate compensation methods?

The professor can propose that the students fill out the following table (see Table 3), indicating the advantages and disadvantages, for the company and the expatriates, of the different methods of compensation used by CFB Co.

Year	Number of expatriates	Compensation method	Advantages		Disadvantages	
			Company	Expatriates	Company	Expatriates
1985 - 1998	Few expatriates	Negotiation approach				
1998 - 2002	25 expatriates	Mixed method				
	- 20 <i>seniors</i>	International approach				
	- 5 <i>juniors</i>	Balance sheet approach				

This exercise in the comparison of methods will allow students to properly understand the differences between the methods of compensation of expatriates.

The negotiation approach was used by the company at the beginning of its international activities from 1985 to 1998. Because CFB Co. had little international experience, it tried to keep the management of expatriates flexible and justifiable. However, even if this approach is easy to manage and requires little data, there is a risk of creating inequities between the expatriates, and that the system will become costly when there are more expatriates. This method can also be time-consuming because the compensation contracts have to be renegotiated each time the country of the posting changes.

The balance sheet approach applies to Paul Fierman as a junior expatriate. Following this approach, the employer attempts to equalize the buying power in the host country with what the expatriate enjoyed in his host country, assuming the costs that exceed the expenses that the

expatriate would normally have to make in his home country. This method presents many advantages: it allows the expatriate to maintain his lifestyle, it facilitates the adaptation of family members to the changes in daily life in a foreign country, it facilitates the repatriation and promotes internal equity in relation to peers in the host country. However, the balance sheet method generates little incentive to accept a posting abroad. To encourage geographic mobility of employees, certain companies offer expatriates particular incentives, like overseas mobility bonuses. In other cases, international experience is seen as a determining factor in career advancement, where the manager who successfully fills his expatriation mandate might receive a promotion in the multinational upon his return (this is the case for Paul Fierman). This approach can be expensive, difficult to manage and requires a lot of information about the cost of living index, salary comparisons and foreign tax legislation.

A poll carried out among Canadian multinationals in April and May 2003 by Mercer Consulting and WorldatWork revealed that more than 50 % of companies use the balance sheet approach. Only 10% of respondents use the method of host country compensation, which is basically the local compensation without any other form of indemnity.

The international method applies to senior expatriates at CFB Co. This method clearly favours the expatriates, because the compensation offers are attractive and include various mobility bonuses and the payment of various expenses abroad. This method is very costly for the company. It is therefore essentially reserved for expatriates who have proven themselves in the company, in terms of competence and potential. This approach encourages mobility and facilitates the management of the return because the expatriate continues to progress on the national scale upon his return to the home country.

The mixed method means that different expatriates in the same company can be compensated according to different methods. In the case of CFB Co., the balance sheet approach is applied to juniors and the international method is applied to seniors. For the multinational, this approach seems to be privileged as it lets it apply different methods of international compensation for different categories of expatriates (the differences can be based on international experience, seniority, functions, etc.) and save on costs. On the other hand, it complicates the management of compensation and there is a risk of creating a feeling of inequity between the different categories of expatriates.

2. What do you suggest to the U.S. headquarters' human resources manager in order to improve the expatriate satisfaction / compensation?

Firstly, the international human resource manager must communicate and explain in detail the different types of expatriation, the different types of competencies required and the different compensation methods (balance sheet and international approaches) of international managers. Paul was not realistic in his expectations in relation to his compensation, in part because he was not

properly informed about the compensation policy for international managers in the multinational. In Paul's case, it is important to note that his expatriation also played a training role. Paul's skills are different from those of the senior expatriates with whom he is comparing himself.

Students can propose the following changes in the compensation policy for expatriates. The professor must point out that there is no single correct method for managing the compensation of expatriates, but rather one optimal method according to the organizational culture and strategy of the multinational.

The generalization of the balance sheet approach to all expatriates. To achieve greater equity between international employees and better control labour costs, we could generalize the balance sheet approach, but the seniors would find it difficult to accept a reduction in their actual compensation. The reasons for the change must be explained and the international compensation policy must be communicated to the managers involved. The cafeteria approach. The salary is fixed as a function of the compensation scale in the home country. The company furnishes a total amount of indemnities and the expatriate chooses to spread out this amount per expense that he will make in accordance with his personal needs. This approach creates more flexibility for the expatriate and it can increase his satisfaction as it better meets his needs. However, when the number of options offered to expatriates is high, this option becomes very complex and costly to manage.

The modified balance sheet approach. Here the salary of the expatriate is related to the region of his expatriation, in the case of Paul Fierman, the Pacific Rim. Among the advantages of this approach we find the fact that it matches up well with the company's regiocentric approach, it preserves the link between the structure of compensation and advantages for the expatriate with what is practiced in the home country and thus facilitates repatriation to the country with the better salaries. This approach is quite simple to manage because it offers all expatriates in a given region the same amount of indemnities based on the index of the most expensive country of posting among all the possible destinations in the region. However, this method is more costly than the balance sheet approach and repatriation is more difficult if the salaries in the home country are lower than those of the country of the posting. Finally, this method creates a risk of generating inequities between expatriates posted in different host regions (regions where the cost of living is higher versus regions where it is lower). This method is particularly well-adapted with a regiocentric IHRM approach.

The host country method is traditionally adopted when the expatriate is remaining in the host country for a very long duration or when his return to the home country is not considered desirable by the head office. The expatriate's salary is determined in relation to the salaries offered in the host country for similar positions, the company providing certain allocations and advantages to expatriates and their family members if the lifestyle of the host country is inferior to that of the home country. This alternative does not seem efficient in our case because neither Paul Fierman nor the other senior expatriates seem to want to remain in their host countries for an extended period of time.

Time or Sequence Suggested for Each Point to Be Covered

The students can individually prepare this case study, which would have been handed out at the previous session. The case study can be the subject of a discussion in class lasting about three hours. For example, the professor can spend one hour on the alignment of a strategy and the strategic management of international postings, one hour on the filling of the position and one hour on the compensation of international managers.

ACCOMPANYING TEXTS, CONCEPTS AND THEORIES

The authors suggest that the students read a few of the following texts before they are asked to prepare the case study.

Black, J.S. & Gregersen, H.B. (1999). The right way to manage expatriates. *Harvard Business Review*, March-April, 52-62.

Bennett, R., Aaton, A., & Colquhoun, T. (2000). Cross-cultural training: a critical step in ensuring the success of international assignments. *Human Resource Management*, 39(2&3), 239-250.

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Bonache, J., Brewster, C., & Suutari, V. (2001). Expatriation: a developing research agenda. *Thunderbird International Business Review*, 43(1), 3-20.

Burns, S. (2003). Flexible international assignee compensation plans. *Compensation and Benefits Review*, 35(3), 35-44.

Sims, R. & Schraeder, M. (2005). Expatriate compensation: An exploratory review of salient contextual factors and common practices. *Career Development International*, 10(2), 98-108.

St-Onge, S., Magnan, M., Prost, C. & Biouele, S.-P. (2002). Gérer la rémunération dans un contexte de mobilité internationale: l'art de jongler avec différentes perspectives. *Gestion*, 27(1), 41-55.

- Suutari, V. & Tornikovski, C. (2000). The challenge of expatriate compensation: the sources of satisfaction and dissatisfaction among expatriates. *The International Journal of Human Resource Management*, 32(2), 54-66.
- Waxin, M.-F. & Panaccio, A.J. (2005). Cross-cultural training to facilitate expatriate adjustment: it works! *Personnel Review*, January, Special Issue on Global Human Resource Management.
- Waxin, M.-F. (2004). Expatriates' interaction adjustment: the direct and moderator effects of culture of origin. *International Journal of Intercultural Relations*, 28(1), 61-79.
- Waxin, M.-F. & Chandon, J.-L. (2003). L'adaptation au travail des expatriés: ses déterminants et l'effet du pays d'origine. *Revue de Gestion des Ressources Humaines*, 47(1), 57-71.
- Wentland, D.M. (2003). A new practical guide for determining expatriate compensation: the comprehensive model. *Compensation and Benefits Review*, 35(3), 45-50.

LINKS WITH CONCEPTS AND THEORIES

The professor has the choice to introduce these themes before the discussion of the case study or to use the case study to introduce these concepts and theories:

Different internationalization strategies for multinationals;
The filling of positions and compensation in an international context;
The management of international managers.

ADDITIONAL BIBLIOGRAPHY TO HELP THE PROFESSOR

- Bonache, J. & Fernandez, Z. (1997). Expatriate compensation and its link to the subsidiary strategic role: a theoretical analysis. *The International Journal of Human Resource Management*, 8(4), 457-475.
- Forster, N. (1997). The persistent myth of high expatriate failure rates: a reappraisal. *The International Journal of Human Resource Management*, 8(4), 415-433.

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- Harvey, M. (1993). Empirical evidence of recurring international compensation problems. *Journal of International Business Studies*, 24(4), 785-799.
- Latta, G.W. (1999). Expatriate policy and practice: a ten-year comparison of trends. *Compensation & Benefits Review*, 31(4), 35-39.
- Martocchio, J.J. (1998). Strategic compensation: a human resource management approach. *Institute of Labor and Industrial Relations*, 311-339.
- Reynolds, C. (1997). Expatriate compensation in historical perspective. *Journal of World Business*, 32(2), 118-132.
- Saba, T. (2001). La GRH dans les entreprises internationales : une réalité complexe et des exigences nouvelles. *Effectif*, janvier-février-mars, 22-30.
- Stroh, L.K. & Caliguiri, P.M. (1998). Increasing global effectiveness through effective people management. *Journal of World Business*, 33(1), 1-17.
- Welch, D. (1994). Determinants of international human resource management approaches and activities: a suggested framework. *Journal of Management Studies*, 31(1), 139-163.

SELECTED QUESTIONS FOR CASE DISCUSSION

Topic 1: Alignment of International Strategy and Headquarters' Orientation Regarding the International Hrm Policy

1. Which internationalisation strategies do you recognise in this case study?
2. What is the HRM orientation adopted by the headquarters? What comments can you make concerning this choice? What can you recommend to the company's headquarters in this sense?

Topic 2: Expatriation Management

1. Is Paul Fierman a good candidate for this expatriation position?
2. What comments can you make on the expatriation management in general? And what comments can you make on the expatriate recruitment policy in particular?

Topic 3: Compensation of International Staff

1. What are the different expatriate compensation methods you recognised in the text? What are the advantages and disadvantages of these different expatriate compensation methods?
2. What do you suggest to the U.S. headquarters' human resources manager in order to improve the expatriate satisfaction / compensation?

GETTING STARTED IN THE THOROUGHBRED HORSE BUSINESS: A REVIEW OF SOME BASIC ACCOUNTING PRINCIPLES

Richard H. Fern, Eastern Kentucky University

CASE DESCRIPTION

This case, for beginning accounting students, reinforces some common accrual accounting concepts in an interesting setting. The body of the case is also available in CD version with a dramatized story and summaries of the data for students to refer to while answering the questions (to get a CD, contact the author directly). The key concepts include revenue and capital expenditures, product and period costs, profit and loss, cash flows, fixed assets and depreciation, inventory costing, indirect costs, cost allocation and cost of goods sold. Due to the concepts covered, it is appropriate to use during the second half of the course after students have been exposed to fixed assets, inventory, profit and loss and cash flow reporting. The case should take about 30 to 45 minutes of class time with about two hours of out-of-class preparation for each of the three sets of discussion questions.

CASE SYNOPSIS

The case centers on the breeding and racing operations of a small Thoroughbred horse business whose owner has little business or accounting knowledge. The business has two distinct operations, racing and breeding. Students discover that the Thoroughbred breeding industry is primarily a manufacturing business with the mares serving as production equipment and the foals serving as inventory. Racing operations are similar to many other businesses with fixed assets (racing stock) and operating costs (board, transportation, vets, race entry fees, jockey purses, etc.). In this case, the owner financed her operations with a large bank loan so the concept of cost allocation and indirect costs for interest are also introduced. Students are asked to identify the cash flows, list the product and period costs, recommend a depreciation policy for each operation and reconcile the cash flow to income.

Instructors are given sufficient background information on accounting and reporting issues in the Thoroughbred industry to allow adequate feedback and guidance to the students. Since most Thoroughbred horse businesses are not public companies, they primarily report on an income tax basis. Some basic, relevant tax issues are presented as background for instructors. Short summaries of the history of the Thoroughbred breed, naming foals and the Triple Crown of racing are provided for interest.

The case is also available on CD with a dramatized story line and appropriate data summaries for use by students (contact the author directly to obtain the CD from which copies can be made).

INSTRUCTORS' NOTES

Suggestions for using the case

The category I discussion questions by themselves cover most of the accounting concepts in the case related to fixed asset accounting. The category II questions introduce the concept of inventory accounting. Questions 1 and 2 of the category III questions (which rely on information from Questions II-1 and II-4) take a larger view and ask students to make a recommendation on which of the two operations the owner should concentrate in the future. This is a broader business issue than pure accounting but will make students consider the implications of the reported numbers and not just be content with doing the calculations. There is no “correct” answer to the category III questions which might lead to some good student interaction as they justify their choices.

Most of the tax-related information in the Teaching Notes is ancillary and is not needed for students to solve the case. It is provided primarily for instructor background and response to specific student questions.

An early review of the chronology of events with the students will prevent some misunderstandings later in the discussions. Gina and Carol are having their discussion in early 2005 as they review Gina’s horse operations for the previous year, 2004.

Late 2003:	Gina acquires Rockin’ Robin and Lady Delight (in-foal mare)
January 2004:	Gina gets a \$500,000 loan pays cash for Robin and Lady Delight
January – April 2004:	Rockin’ Robin is in training
March 2004:	Foal (Dan D Dancer) is born
April 2004:	Lady Delight is bred to a stallion
May 2004:	Rockin’ Robin begins his racing career
July 2004:	Dan D Dancer weaned away from Lady Delight
July 2005:	Expected auction sale of Rockin’ Robin

While all of the Thoroughbred and racing industry jargon used in the case is fully explained in the case text (or video), students will forget or ignore the explanations and misinterpret some facts and figures. As part of each class discussion, instructors should review some of the terminology such as “FP/TF” (race ‘finish position’ and ‘total horses in the field’).

Recommended Progression of Assignments

Class testing of this case shows that many students will not fully read the case instructions (or listen to the available case video). It's very important that the basic story line and chronology of events are fully understood. To this end, it's best if the first assignment is limited to reading the case (or watching the available CD video). This should be followed by a brief case in-class orientation on the facts and order of events. This will preempt a lot of later questions and misunderstandings.

Following the introductory class orientation, assign only questions I-1 and I-2 as the next stage of completion. From the class discussion on these two questions, students will have one more chance to fully understand the story, chronology of events and what cash flows are relevant to the racing operations. This should be followed by subsequent assignments of only one or two questions each. Class testing has shown that the learning effects are maximized when the case is presented in smaller, "digestible" chunks rather than all at once. There is a learning curve within the entire case and also within each category of questions.

Instructor's Background Material

Most Thoroughbred horse businesses only prepare financial statements for tax purposes since they aren't public companies and aren't subject to GAAP requirements. For teaching purposes, the solutions to this case are presented in accordance with full-accrual GAAP rules, unless otherwise noted.

Specific, detailed tax rules for livestock present some interesting challenges and are beyond the scope of this exercise. However, some of these issues may arise in the class discussions so some tax background may be helpful for instructors.

The uniform capitalization rules for inventory (IRC Sec. 263A) apply to Thoroughbred operations with gross receipts greater than \$25 million. Thus, for large Thoroughbred operations, much of the tax accounting is similar to accrual-basis GAAP. For example, under the Uniform Cap rules, any homebred foal costs would include the birth year's depreciation on the mare, the nomination (stud) fee for the stallion sire and the vet charges, training costs, etc. These costs would become part of the cost of sales if the foal is eventually sold or become the basis for depreciation if the animal is eventually used for racing or breeding.

Uniform Capitalization rules don't apply for smaller operations (gross revenue less than \$25 million), such as in this case. For tax purposes, Gina would use a modified-cash basis and expense all costs incurred other than the acquisition costs of her breeding and performance stock. Her tax basis in any homebred foal would be \$0.

Tax rules require MACRS depreciation including a special Sec. 179 allowance of \$100,000 per year. Straight-line MACRS is an available option. Race horses over two years old and breeding

stock over 12 years old (based on actual age, not the industry age as of January 1) are three-year property for MACRS and all others are seven-year property.

All solutions presented here are in GAAP form even though, for tax reasons, Gina would use the modified cash basis as discussed above.

DISCUSSION QUESTIONS

I-1: Discuss, in general, the different ways that a business owner might determine how well their business has performed.

By mid-term, most students in introductory financial accounting are already indoctrinated into thinking of business success as either net income (loss) and will offer these measures of business success. Other student suggestions might include some alternative measures such as the owner's personal satisfaction with the business, having a positive cash flow, having cash in the bank at the end of each month or having more assets than liabilities. Those with a finance perspective might suggest that success comes from meeting some pre-determined cash pay back or exceeding a hurdle rate of return on investment.

The objective of the first question is to get students to think qualitatively and quantitatively about how business success is measured. In general, the income statement and statement of cash flows are the two primary ways of measuring how well a company has achieved its goals. While other measures are worthy of class discussion, in a business context, creditors and investors will look primarily at these two financial measures.

I-2: Compute Gina's cash inflows and outflows from the racing operations for last year (2004). Show each inflow and outflow separately.

As students attempt this question (and the other category I questions) remind them that they relate only to the 2004 racing operations (Rockin' Robin's activities). The breeding operations of Lady Delight and her foals are addressed in the category II questions. Instructors should clarify that Gina actually got possession of Rockin' Robin in late 2003 but the cash payment was not made until early in 2004 after the loan proceeds were received.

Question I-2 will likely be the easiest question for students to answer since the cash flow dollars are all identified in the case and few recognition decisions have to be made. Be sure that students understand that the assumptions used in the solution are that Rockin' Robin was in training all year (365 days), interest ran from January 1, 2004 and the prime rate of 6% (quoted as of May 2005) didn't change during the year. In preparing the summary of cash flows, instructors may want to review the statement of cash flow topics by

requiring a formal statement. While not vital to the case solution, having students distinguish among the operating, investing and financing activities does help in the discussion in question 5. Students can locate the current prime rate of interest on the Web, in the newspaper or the instructor might provide it.

Gina's Racing Operations
Statement of Cash Flows
FYE December 31, 2004

Cash from (to) operating activities:

Racing purses (see supporting detail)	\$ 144,200	
Training	(27,375)	
Vet	(3,600)	
Blacksmith	(1,200)	
Racing fees	(3,700)	
Trainer, jockey and farm % of purses	(33,166)	
Interest (see supporting detail)	(20,000)	\$55,159

Cash from (to) investing activities:

Purchase Rockin' Robin	(200,000)	
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Cash from (to) financing activities:

<u>Loan proceeds</u>	<u>200,000</u>	
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Total increase in cash for year

\$55,159

Supporting computations:

Racing purses:	<u>Total Purse</u> %	<u>Winnings</u>
	\$47,000 20%	\$ 9400
	47,000 60%	28,200
	56,000 60%	33,600
	65,000 20%	13,000
	100,000 60%	<u>60,000</u>
		\$144,200
Training: (365 days @ \$75)		\$27,375
Vet: (12 months @ \$300)		\$ 3,600
Blacksmith: (12 months @ \$100)		\$ 1,200
Trainer, etc. % of purses: (23% x \$144,200)		\$33,166
Interest : Loan		\$500,000
Prime rate (May 2005)	6%	
Plus 4%	<u>+4%</u>	
Total rate		<u>x 10%</u>
Annual interest on all horses		<u>\$50,000</u>
2/5 to racing stock (\$200,000/ 500,000)		\$20,000

I-3: Using the accrual basis, identify the types of revenues and costs related to Gina's racing operations. Classify each of the costs as either a capital expenditure or revenue expenditure (expense). Explain your answers.

To avoid confusion, instructors should clarify for students the difference between cost (the price paid for to acquire a resource) and expense (the amount of the resource's cost that is currently charged to operations). Students will likely identify the following costs as being related to the racing operations: purchase price of Rockin' Robin, training, veterinarian, blacksmith, transportation, racing fees and interest on the loan. The revenues for the racing operation are the racing purses.

Revenue expenditures are outlays of funds that only benefit one accounting period or whose future benefit is uncertain; in other words, a current expense. Generally, these are considered the outlays for ordinary maintenance and repair after a fixed asset is placed into service. These same costs are capitalized during the acquisition and preparation stages of fixed asset use.

The main asset in horse racing is the racing stock (a fixed asset). The revenue expenditures for the racing operations relate to repair and maintenance on the "fixed asset" such as training, vets, blacksmiths, transportation and interest for May through December 2004. Since Robin's first race wasn't until May, these costs would be capitalized until then (Robin was "placed in service" in May when he began racing).

Capital expenditures are outlays that provide a benefit into the future; in other words an asset. This includes all costs to acquire an asset and get it ready for its intended use including operating costs prior to asset use. For Rockin' Robin, this would include the acquisition cost and all training and other costs prior to the beginning of his racing career. Since his first race was in May, all "maintenance" costs would be capitalized through April. The capital expenditures are the purchase price of the horse and the above revenue expenditures through April.

The interest cost should raise some questions from students since the loan provided funds for the racing activity as well as the breeding operation. This is a good point to discuss expense relationships and allocations. While some costs are directly related to an activity (e.g. purchase and training costs) other necessary costs don't directly benefit just one activity. Students might suggest splitting the interest based on total expenditures for each activity (breeding and racing) or on some other allocation base. In that case $\frac{2}{5}$ ($\$200,000 / \$500,000$) of the interest would be allocated to racing. Other students might suggest not allocating any interest to the specific activities and only considering it as a total, but unallocated expense (e.g. similar to corporate overhead).

Some perceptive students might ask about the possibility of capitalizing some of the interest cost since it was partly incurred before Robin began racing. Under GAAP,

interest is to be capitalized during the construction period for self-constructed assets (SFAS No. 34). Conceptually, that might apply to horses are in training but have not yet begun their racing career. However, since most accounting principles books omit this concept, this topic was considered beyond the scope of the case.

I-4: Explain how the capital expenditures identified in answer I-3 would be treated for accounting purposes in the current and future years. Include an estimate of how much of each of the capital expenditures should be expensed in 2004. Be specific

[Note: At this point in the case, some students will still not have recognized that Rockin' Robin is just another fixed asset. Once that point is clarified, they can then more easily relate it to the course material on depreciation. It's very important that students make the connection between Robin and fixed asset accounting since that makes the depreciation discussion much more understandable.]

Capital expenditures for assets with determinable lives are allocated over their expected life to the owner. The \$200,000 acquisition cost of Rockin' Robin and the continuing costs for January through April should be capitalized and depreciated over his expected useful life. The continuing costs to be capitalized are: daily training fees \$9000 (\$75 x 120 days); monthly vet charges \$1200 (\$300 x 4 months); and monthly blacksmith charges \$400 (\$100 x 4 months).

Instructors may want to keep the depreciation concepts simple and go with the likely student recommendation of straight-line write-offs. Students should question what a "normal" depreciation period is for livestock and will, of course, want the instructor to tell them the "correct" number of years and an expected salvage value. Challenge the students to recommend their own logical depreciable life even though they are unlikely to have much background in this area. This should bring up some discussion of "useful" life and how it depends on both the asset's total economic life and on the owner's intentions and pattern of use.

[Instructor note: For tax purposes, race horses less than two years old and breeding stock less than twelve years old are both seven-year property under MACRS. The optional straight-line depreciation percentages for seven-year property are: first year is 7.14%; second through seventh year, 14.29%; eighth year, 7.14%. Racing stock over two year's old and breeding stock over 12 years are depreciated over 3 years. For tax purposes, chronological age is used rather than the industry uniform age standard used in racing classification. Although not explicitly mentioned in the case, Robin was likely born before January 2003 since most horses don't race consistently until they are at least three years old. This makes Robin three-year property since he was over two years old when "placed in service".]

Rockin' Robin was purchased in late 2003 for \$200,000 and began racing in May 2004. Between purchase and the start of his racing career, another \$10,600 of additional costs were incurred that should be capitalized. Depreciation would not begin until the month and year he began racing. Since the half-year convention and MACRS are beyond the scope of most accounting principles courses, normal straight-line depreciation to the nearest month for 2004 would be \$46,800 [$(\$210,600 / 3) \times 8/12$]. For all depreciation calculations in the case, a salvage value of \$0 was assumed.

Some students might suggest that Robin's economic life is only one year (2004) since Gina plans to sell him in the 2005 summer auction. In this case, as no racing was planned for 2005, his "useful" life is only one year. Since Gina hasn't fully determined that issue, a more realistic life of 3 to 5 years would probably be recommended. Stress to the students that even in the best situations economic life is only an estimate since most owners don't know, originally, how long they will use the asset. A related issue for discussion would be what happens if an owner chooses an unrealistically short or long asset life for an asset. (Note: The issue of economic life might come up again in question 1-7 when the cost of goods sold and gross profit on sale are discussed.)

I-5: Compute Gina's accrual accounting income or loss from the racing operations for last year. Prepare a detailed income statement. Present any supporting calculations that are needed.

Gina's Racing Operations	
Statement of Profit and Loss	
FYE December 31, 2004	
Revenues – Racing Purses	\$144,200
Operating Expenses:	
Racing costs (%s & fees)	\$36,866
Depreciation	46,800
Training	18,375
Blacksmith & Vet	<u>3,200</u>
	<u>(105,241)</u>
Income from Operations	38,959
Other Expenses:	
Interest	<u>(20,000)</u>
Net profit (loss)	\$ 18,959

Additional supporting computations:

Depreciation: $(\$210,600 / 3 \text{ years}) \times 8/12$	\$46,800
Training: $(\$75 \times 245 \text{ days})$	\$18,375
Vet & Blacksmith: $(\$400 \times 8 \text{ months})$	\$ 3,200
Interest: $\$500,000 \times 10\% \times (200,000 / 500,000)$	\$20,000

I-6: Do cash flows equal accounting income or loss? Why or why not? Reconcile (explain the differences) between your answers in question I-2 and I-5.

Although challenging, this question was included since this is such an important concept at all levels of financial accounting. This question should be assigned by itself since it's perhaps the most time consuming item in the case.

Cash flows from operating activities and income or loss from an accrual accounting perspective are measures of a similar set of activities (i.e. operating activities) but generally are not the same amount due to deferrals, accruals, prepaid items and non-cash expenses. Also, total changes in cash for a period include investing activities (buying and selling long-term assets) and financing activities (borrowing and repaying debt; interest costs).

Most students will need some guidance with this question since the cash flow topic is traditionally one of the more difficult topics in introductory financial accounting. Instructors might approach this question by reconciling total cash flows to net income (including investing and financing flows) or focus only on the operating cash flows. For reference, refer students to the text book's net income-to-operating cash flow calculation for the indirect method on the cash flow statement.

For Gina's racing operations, the difference in total changes in cash and net income are the loan proceeds, the purchase of Robin, the capitalized operating costs and Robin's remaining book value:

Increase in cash (Question 1)		\$ 55,159
Less: Loan proceeds not included in profit		(200,000)
Add: Cost of Rockin' Robin	\$200,000	
Amount depreciated	<u>- 46,800</u>	
Book value at 12/31/04		153,200
Capitalized operating costs		<u>10,600</u>
Net profit (Question 4)		\$ 18,959

For consistency with the book discussion of operating cash flow-to-net income calculations, the following schedule might be more meaningful:

Net Profit	\$ 18,959
Add: Depreciation expense	46,800
Deduct: Capitalized operating costs	<u>(10,600)</u>
Cash generated from operating activities	\$ 55,159

Loan proceeds are included in cash flow calculations but they are not part of the income calculation. For cash flows, the entire cash cost of a long-lived asset (fixed asset) is subtracted; only the amount of the current year's depreciation is deducted in computing

accrual-basis income. Operating expenses added to an asset's depreciation base reduce cash but do not reduce income other than through depreciation charges.

I-7: If Gina sells Rockin' Robin in July 2005 for \$750,000, compute her gross and net profit on the sale. Show any supporting calculations.

The summer horse auctions are assumed to be in July 2005, so another six months of depreciation is needed for 2005.

Selling price		\$750,000
Less: Book value (cost of goods sold)		
Purchase cost of Rockin' Robin	\$200,000	
Depreciation: 2004 (see above)	(46,800)	
2005 (Jan.-June)	<u>(35,100)</u>	
Book value as of July 2005		118,100
Gross Profit		631,900
Less: Selling expenses - agent fees 15% of price		(112,500)
Selling expenses – prep fees		<u>(3,000)</u>
Net profit		\$516,400

II-1: Compute Gina's cash inflows and outflows from the breeding operations for last year (2004). Show each inflow and outflow separately.

Answering the category II questions should be easier for students since their answers to the category I questions will have clarified much of the case detail. On the category II questions, make sure that students focus only on the breeding operations and don't accidentally pick up some racing items.

Gina's Breeding Operations
Statement of Cash Flows
FYE December 31, 2004

Cash from (to) operating activities:		
Board – Mare	(12,775)	
Board – Foal	(8,270)	
Vet - Mare	(3,600)	
Vet – Foal	(3,500)	
Blacksmith- Mare	(1,200)	
Blacksmith – Foal	(1,000)	
Stallion fees	(26,500)	
		(56,845)

Cash from (to) investing activities:		
Purchase Lady Delight		(300,000)
Cash from (to) financing activities:		
Loan proceeds	300,000	
Interest	(30,000)	270,000
Total increase in cash for year		\$(86,845)

Assumptions: Dan D Dancer was born in early March 2004, so Gina incurred boarding costs for 10 months. Dan D was weaned in July, so boarding costs were \$15 @ day for 122 days (March – June). Dan D’s boarding costs were \$35 @ day for 184 days (July – December). Gina incurred vet and blacksmith costs for Dan D for 10 months (March – December).

Supporting computations:

Board: Mare	(365 days @ \$35)		\$12,775
Foal	(122 days @ \$15)	\$ 1,830	
	(184 days @ \$35)	<u>\$ 6,440</u>	\$ 8,270
Vet: Mare	(12 months @ \$300)		\$ 3,600
Foal	(10 months @ \$300) + \$500		\$ 3,500
Blacksmith:	Mare (12 months @ \$100)		\$ 1,200
	Foal (10 months @ \$100)		\$ 1,000
Interest : Loan		\$500,000	
Prime rate (May 2005)		6%	
Plus 4%		<u>+4%</u>	
Total rate		<u>x 10%</u>	
Annual interest on all horses		<u>\$50,000</u>	
3/5 to racing stock (\$300,000/ 500,000)			\$30,000

II-2: Using accrual accounting, identify the types of revenue and costs related to Gina’s breeding operations. Classify each of the costs as either a capital expenditure or revenue expenditure (expense). Explain your answers.

While there are other costs that might be included in this analysis, the details have been kept to a minimum to allow students to focus on the issues and not the numbers. Students will likely identify the following costs as being related to the breeding operation: purchase price of Lady Delight, boarding for the mare and foal, veterinarians,

blacksmith and interest on the loan. Neither of the two revenues – racing purses and sales proceeds from the three year old - is related to the breeding operation.

Revenue expenditures are outlays of funds that only benefit one accounting period or whose future benefits are uncertain; in other words, a current expense. The revenue expenditures for the breeding operations are boarding, vets, blacksmith, and interest.

Capital expenditures are outlays that provide a benefit into the future; in other words an asset. The capital expenditures are the purchase price of the mare and the stud fees.

[Summary of accounting in the Thoroughbred horse industry: Under tax rules, large operations (gross revenue over \$25 million) must follow the Uniform Capitalization Rules. These tax rules are very similar to full-accrual GAAP rules under which acquisition costs for breeding stock are capitalized and depreciated (similar to fixed assets in manufacturing). Annual operating costs for breeding stock such as board, vets and blacksmiths are expensed (similar to routine maintenance costs on manufacturing equipment). Primarily, breeding stock is treated as a fixed asset.

During their early years, foals are treated as inventory for accounting purposes. Direct costs of breeding, delivery and keep are accumulated (i.e. product costs for work in process). Depreciation on the mare, the nomination fee for the sire (stud fees) and all boarding costs are accumulated for the foals. Additionally, part of the acquisition cost for mares with in-utero foals (pregnant mares) is allocated to the foal as a direct product cost. Product costing treatment continues for the foal's boarding costs.

When foals are raised for eventual sale, these accumulated costs become part of their cost of goods sold. For foals that enter racing, these accumulated costs (along with their training costs) are capitalized until they begin their racing career. At this point, depreciation begins for the accumulated costs and the subsequent training costs are expensed as incurred.

For small Thoroughbred operations, a modified-cash basis is used whereby all costs are expensed other than the cost of animal acquisitions. For tax purposes, Gina would use this approach. For purposes of this case, however, full accrual accounting (similar to tax-based Uniform Cap rules) is applied.]

II-3: Explain how the capital expenditures identified in answer II-2 would be treated for accounting purposes in the current and future years. Include an estimate of how much of each of the capital expenditures should be expensed in 2004. Be specific.

The accounting issue is cost deferral where capitalized costs are allocated over the periods of expected benefit. Obviously, the \$300,000 cost of the mare would be

capitalized but should part of the cost be allocated to the foal since the mare was pregnant when purchased? Under the Uniform Capitalization rules for taxation, such fees are allocated and this will also be required under GAAP rules. In this case, 1/3 of the cost of the in-foal mare was allocated to the foal. Lady Delight would be capitalized at \$200,000; Dan D Dancer at \$100,000. This is entirely consistent with cost allocations in other business settings and, in fact, is a common practice in the Thoroughbred industry.

In addition, Dan D's capitalized costs would include his mother's depreciation for the year, the stallion breeding (stud) fees and all other costs incurred during the year (vets, blacksmith, and board). Since Dan D has not yet been "placed in service" during 2004, capitalization of costs continues. If Dan D begins racing, his accounting status changes from inventory to fixed assets and the accumulated costs would be depreciated. Or, if Dan D is later sold, these costs become cost of goods sold.

Some students will question whether the stallion breeding fees should be capitalized. Or, if so, as part of which horse – the mare or the resulting foal? What happens to the cost if the foal doesn't survive to LFSN ("live foal, stand and nurse" which is a common breeding guarantee)? The stud fee is a direct acquisition cost for the foal and should be allocated accordingly. If the foal doesn't survive, all deferred costs for the expected foal should be immediately expensed.

At this point in their principles course, most accounting students will already have some concept of current and long term assets as well as inventory and fixed assets. They should quickly see that the mare is a type of long-term, fixed asset since she is used by Gina to generate revenue (a fixed asset) and is not for sale in the ordinary course of business (inventory).

The capitalized cost for Lady Delight would only be the purchase price allocation of \$200,000. Her operating costs (e.g. board, vets, etc) will be expensed similar to machinery operating and maintenance costs. Instructors will want to keep the depreciation concepts simple at this point, and probably recommend straight-line write-offs as is done in most principles textbooks. Students should question what a "normal" depreciation period is for livestock and will, of course, want the instructor to tell them the "correct" number of years. Challenge the students to recommend their own logical depreciable life even though they are unlikely to have much background in this area.

Brood mares can have a surprisingly long career, often continuing to breed for 10 years or more. Using a 10-year life, the 2004 depreciation for Lady Delight will be \$20,000 (\$200,000 /10 years).

See the discussion of tax depreciation rules in Note 1-4 above.

II-4: Compute Gina’s accrual accounting income or loss from the breeding operations for last year. Prepare a detailed income statement. Present any supporting calculations that are needed.

Gina’s Breeding Operations Statement of Profit and Loss FYE December 31, 2004		
Revenues		\$ 0
Operating Expenses:		
Board-Mare	12,775	
Blacksmith & Vet-Mare	<u>4,800</u>	<u>(17,575)</u>
Income from Operations		(17,575)
Other Expenses:		
Interest – Mare		(20,000)
Interest - Foal		<u>(10,000)</u>
Net profit (loss)		\$ (47,575)

Additional supporting computations:

Depreciation: There are no depreciation charges for Lady Delight since those costs would be capitalized as part of the cost of the foal, Dan D Dancer. There are no depreciation charges for Dan D Dancer since he hasn’t been “placed in service” yet.

Boarding:	Mare only	12,775
Vet & Blacksmith:	Mare only	4,800
Interest:	Mare: $\$500,000 \times 10\% \times (200,000 / 500,000)$	20,000
	Foal $\$500,000 \times 10\% \times (100,000 / 500,000)$	10,000

II-5: Reconcile (explain the differences) between your answers in II-1 and II-4.

The differences between the net loss and cash flows from breeding operations are the loan proceeds, cost of the animals, depreciation on the mare and the capitalized costs for the foal including the breeding fee.

Increase in cash (Question II-	\$ (86,845)
Less: Loan proceeds not included in profit	(300,000)
Add: Cost of Mare and Foal	300,000
Capitalized breeding fee	26,400
Capitalized operating costs - Foal	<u>12,770</u>
Net profit (loss) (Question 4)	\$ (47,575)

III-1: Compute Gina's overall, combined income or loss from her Thoroughbred horse operations for last year (2004). Prepare a detailed income statement showing the separate types of revenue and expenses (e.g. operating, non-operating, etc). Present any supporting computations that are needed.

Gina's Thoroughbred Breeding and Racing Operations		
Income Statement		
For year ended December 31, 2004		
Revenues:	Racing purses	\$144,200
Expenses:		
	Racing: Training, Vets & Transportation	\$7,300
	Depreciation - Rockin' Robin	<u>9,933</u>
		\$ 17,233
	Breeding: Boarding & Vets	11,450
	Total Expenses	<u>28,683</u>
	Operating Profit	115,517
	Interest Expense (\$500,000 x 10%)	<u>50,000</u>
	Net Profit (Loss)	\$ 65,517

III-2 Make a recommendation to Gina concerning the future of her racing and breeding operations. Make suggestions as to which activities to pursue versus those activities to cease. Consider other criteria besides cash flows and profit or loss.

Gina has financial results for only one year, so making any long-term projections is risky based on such limited evidence. Profit-wise, Gina did the best in 2004 in her racing operations. This is the only place that she had any revenue. Her breeding operations didn't generate any revenue in 2004 since she didn't sell any foals. Her 2004 racing was successful, but can she duplicate or improve that year after year?

Perhaps, on their own, students will recognize that success on the race track and in the sales pavilion is not always so lucrative. They should have already concluded that the Thoroughbred horse business is very risky regardless of whether one is involved in racing or breeding. The costs are large and there is no guaranteed pay-off. Success on the track and in the breeding barn often depends a lot on luck rather than good business practices.

Gina feels that the breeding activities show the best long-term opportunities although her view is limited right now. If she can sell Dan D in the 2005 sales, she would then be generating some breeding revenue. Long-term revenue streams will depend on her success in picking mares and sires, Mother Nature and the Thoroughbred economy in general. Only one of these factors can she directly control.

If Gina's projected numbers are accurate, she had a 13 per cent net profit margin (\$18,959/ \$144,200) on her racing in 2004 and she had a positive cash flow from operations (her cash flow pattern reflects that of a growing business). On the other hand, both of these financial measures were negative for her breeding operations since there was no revenue. In this setting, the annual accounting period is misleading as to Gina's breeding operations since she is still in the start-up phase. It's really too early to know if she can be successful in either activity.

DEVELOPING A STRATEGIC NEGOTIATION PLAN: TOYOTA HIGHLANDER

Michael R. Luthy, Bellarmine University

Mike H. Ryan, Bellarmine University

Bettye R. Desselle, Prairie View A&M University

John T. Byrd, Bellarmine University

CASE DESCRIPTION

The primary subject matter of this case concerns the evaluation of gathered information to develop a negotiation plan prior to a consumer's purchase of a sport utility vehicle. Secondary issues examined include the sales process and the increasing role of the Internet in consumers' information search activities. The case has a difficulty level of one (appropriate for freshman level courses) although it may be used through level five (appropriate for first year graduate level) depending on the amount and complexity of background reading assigned. The case is designed to be taught in as little as one class hour, but may be expanded to as many as three class hours depending on the amount of theoretical material discussed by the instructor, if role-play negotiations are carried out, and whether any out-of-class preparations are assigned. The case is expected to require from zero to approximately four hours of outside preparation by students.

CASE SYNOPSIS

Introducing students to the topic of sales negotiation is always challenging. While it is typically a significant part of business-to-business purchases and many higher-ticket priced consumer goods, negative word-of-mouth and uncomfortable personal experiences leave many students apprehensive. Presenting the topic in the context of purchasing an automobile, or in this case study, negotiating the purchase of two sport utility vehicles, students will draw on their own experiences, those of their friends and family members, and any assigned readings. The overall goals of the case are to defuse the anxiety many students associate with negotiation, underscore the importance of analysis and planning prior to face-to-face encounters, and better prepare students for future business and personal purchase situations where negotiation is a factor. Specifically, in this case students examine collected price and non-price information, and develop a negotiation plan. Through this task the instructor may explore various fundamental aspects of negotiation (e.g., agenda analysis, concession strategies) and the distributive bargaining model (e.g., aspiration targets, reservation points, buyer and seller surplus).

INSTRUCTORS' NOTES

Pre-class Readings and Student Preparation

If the instructor wants to minimize student preparation for the case, either as a prelude to “off the cuff” discussions of negotiation experiences and impressions of car buying, or to better fit the goals for this case with other course objectives, no formal readings need be required to discuss this case. Due to the issues the case raises and its flexibility of use with different student populations, depending on how the case fits with the instructor’s goals for the session, selected readings may be assigned. Relevant readings and brief descriptions listed by student level are presented in Exhibit 3.

As part of the learning process instructors may also find it useful to discuss the case in the larger context of different sales situations. To that end there are resources available that present student role plays involving sales and/or negotiations. *The professional selling skills workbook* (1995), edited by Avila et al. contains numerous tools that can be used for this purpose. Role playing the selling side of the Toyota Highlander negotiation can be beneficial to students accustomed to only viewing these types of interactions from the buyer’s vantage point.

Exhibit 3 Suggested Readings

Level One (Freshmen)

The Only Four-Page Guide to Negotiating You'll Ever Need, by Walter Kiechel. *Description:* Everyone engages in negotiating all the time, whether they realize it or not. Preparation is critical to the success of the process. You will need to prepare on two fronts: getting the right attitude, and gathering information on what your interests are and what the other party's might be. Looking at the overlapping interests of both parties is important; pay special attention to possible alternatives to negotiation. Once the two parties have explored their respective interests together, they may well be able to arrive at an outcome not contemplated in either's initial offer but that satisfies each far better than the result of a long haggle. You can't banish emotions from the proceedings. Rather, the point is to get feelings into the open, acknowledge them, and minimize them as obstacles. Some of the experts recommend that you resist making the first offer yourself, while one cited an example where the initial offer determined the eventual settlement. Measured progress is definitely better than hasty decisions. Harvard Management Update Article, product number U9609A, length 4 pages.

Ethics in Negotiation: Oil and Water or Good Lubrication?, by H. Joseph Reitz, James A. Wall, and Mary Sue Love. *Description:* Is ethical negotiating not only “the right thing to do,” but also effective in achieving desired outcomes? Various ethical criteria (the Golden Rule,

Universalism, Utilitarianism, Distributive Justice) are used to evaluate ten commonly used negotiation tactics (lies, puffery, deception, weakening the opponent, strengthening one's own position, nondisclosure, information exploitation, change of mind, distraction, and maximization). Some negotiating ploys are unqualifiedly unethical; some are inherently ethical; some are contingently ethical. Unethical bargaining can reap onetime benefits, but in the long run it damages relationships, sullies reputations, and actually closes the door on many potentially fruitful transactions. Business Horizons article, product number BH004, length 10 pages.

Levels Two through Four

Negotiation Analysis: An Introduction, by Michael A. Wheeler. Description: Provides an overview of the seven elements of negotiation analysis. These elements include BATNAs (nonagreement walk-aways), parties, interests, value-creation, barriers to agreements, power, and ethics. Illustrations are drawn from a range of contexts (from buying a car and the sale of a business to dispute resolution and international diplomacy). Harvard Business School Publication, product number 801156, length 14 pages.

Anchoring and First Offers in Negotiation by George Wu. Description: Describes how first or opening offers can be used effectively in negotiation. Examines how opening offers serve as an anchor, changing one side's perception of the other side's bottom line and hence the set of possible outcomes. Harvard Business School Publication, product number 895070, length 3 pages.

Framing and Negotiation, by George Wu. Description: How can framing--alternative description of an object, event, or situation--can be used effectively in negotiation? A real estate dialog is used to illustrate three common varieties of framing: losses versus gains; short and long horizons; and aggregation and segregation. Harvard Business School Publication. Product Number 895023. Length 5 pages.

Expectations and Stereotypes: How Do They Affect the Deal? By Kathleen Valley. Description: Designed to provide students with a basic insight into recognizing the productive and destructive aspects of expectations and stereotypes, and their consequent effects on negotiation. Harvard Business School Publication, product number 396167, length 2 pages.

Level 5 (1st Year Graduate)

Two Psychological Traps in Negotiation by George Wu. Description: Two psychological traps, anchoring and framing, and their role in negotiation are described. The anchoring section describes how first or opening offers can be used effectively in negotiation. Examines how opening offers serve as an anchor, changing one side's perception of the other side's bottom line and hence the set of possible outcomes. The framing section describes how framing--alternative description

of an object, event, or situation--can be used effectively in negotiation. Uses a real-estate dialogue to illustrate three common varieties of framing: losses versus gains, short and long horizons, and aggregation and segregation. Harvard Business School Publication, product number 897036, length: 8 pages.

Diagnosing and Overcoming Barriers to Agreement by Michael D. Watkins. Description: Synthesizes and extends work on barriers to negotiated agreement. Five key types of barriers are described--structural, strategic, psychological, institutional, and cultural. Approaches to overcoming these barriers are discussed. Harvard Business School Publication, product number 800333, length 20 pages.

Additionally, the instructor has the option of requiring students to prepare written answers and a negotiation plan before the class discussion and even conduct mock negotiations by giving select information to different students playing the roles of buyers and sellers.

GENERAL BACKGROUND

The bargaining in this case is typically categorized as a distributive bargaining (or win-lose) model where gains by one party (the buyer) are offset by the other party (the seller) and vice versa. A graphical representation of the model is presented in exhibit 4 (Walton and McKersie, 1965) while terms are defined in exhibit 5.

Exhibit 4: Distributive Bargaining Model

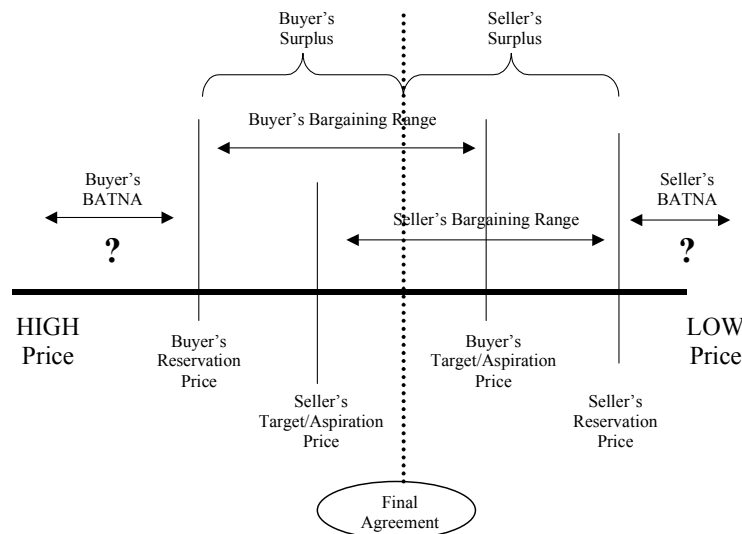


Exhibit 5
Distributive Bargaining Model Term Definitions

Target Price: The “best” price (typically a minimum for the buyer and a maximum for the seller) the negotiation party would like to pay for a given item.

Reservation Price: The price (the absolute maximum for the buyer and the absolute minimum for the seller) the negotiation party will accept. Beyond this point they would rather not reach agreement.

Negotiation Range: The area (or latitude) identified as lying between a party’s target and reservation points

Buyer’s Surplus: The amount that the buyer did not have to pay but was willing to in reaching an agreement.

Seller’s Surplus: The amount that the seller did not have to forgo but was willing to in reaching an agreement.

BATNA: Best Alternative To a Negotiated Agreement; there can only be one best and it must be concrete.

Another possibly useful piece of information in leading the class discussion is the markup on the wholesale prices of the various components Michelle Tipton and the Lacey’s are interested in. This information is presented in exhibit 6.

Exhibit 6			
Toyota Highlander Base Vehicle Costs and Options with Mark-Up			
MSRP	Wholesale	Model and Engineering Options	Mark-Up from Wholesale
\$24,390	\$21,761	4 door sport utility with base engine	12%
25,790	23,007	4 door, 4 wheel drive sport utility with base engine	12%
1,580	1,407	3.0 Liter, 6 cylinder 220 hp	12%
650	559	Vehicle skid control	16%

Exhibit 6			
Toyota Highlander Base Vehicle Costs and Options with Mark-Up			
MSRP	Wholesale	Exterior Options	Mark-Up from Wholesale
\$699	\$455	Fender Flares	54%
310	248	Glass, deep tinted	25%
102	61	Hood protector	67%
220	176	Luggage rack	25%
80	64	Mud guards	25%
625	405	Running boards	54%
334	200	Rear spoiler	67%
900	720	Power sunroof	25%
MSRP	Wholesale	Interior, Security, Safety, and Miscellaneous Options	Mark-Up from Wholesale
\$379	\$235	Molded wood dash	61%
90	58	All weather floor mats	55%
\$147	\$88	Glass breakage sensor	67%
309	185	VIP security system	67%
250	215	Side impact air bags	16%
40	32	Daytime running lights	25%
30	24	Outside heated mirrors	25%
400	352	Heated seats	14%
200	150	Premium sound package with CD changer	33%
520	416	16" aluminum wheels	25%

RESPONSES / ISSUES SURROUNDING QUESTIONS TO ANSWER

- 1. What should Michelle and the Laceys' negotiation strategy be? (e.g. how much information to share concerning where they are in the buying process, that there is a vehicle trade-in, that they are looking at other dealerships as well, that they have**

wholesale price information from Internet sources, whether and how much deception is ethical/allowable, etc.)

Because the buyers in this case have more than one dealership from which to choose (Toyota of Louisville and Green Tree Toyota) and the possibility of representing to the sales staff of these dealerships that they have additional choices – Oxmoor Toyota and even dealerships in Cincinnati, Ohio and Indianapolis, Indiana (within a reasonable drive from Louisville given the high ticket price of the purchase), two extreme endpoint strategies are possible.

The first would be the so-called “full information sharing” option. This involves informing the salesperson at the outset that they plan to purchase two of nearly the identical model, have wholesale price information, have a trade-in, and are going to all area dealerships and asking for their best price for the package. This approach has the appeal of making the other bargaining party aware of the buyers’ informational power and availability of alternative vendors. The principle chief limitation is that it amounts to a power play or ultimatum of sorts where if the seller doesn’t give the lowest price they likely will lose the sale.

At the other end of the spectrum is the so-called “string out the process option.” Under this scenario, the buyers go in to each dealership and to all external appearances “play dumb.” In reality, this approach draws on the increasing investment of time the salesperson spends with one or both potential buyers; answering questions, discovering needs, narrowing down the number of models under consideration, going along on a test drive of the vehicle, explaining and assisting with the buyers’ selection of options, pricing, etc as a means of getting a better deal. While it is true the buyers as well tend to view increasing expenditures of time as more commitment to a purchase, in this case the buyers know a priori what they want. Through selective releasing of information they move toward their ultimate goal – the best price for the purchase of two vehicles. Revealing that they will be visiting other dealerships would come only after a written price quote is obtained. The same is true for the information that a trade-in vehicle will be involved.

Other points along the continuum marked by these two extremes are related to how much, and when, selected information is revealed. A separate but related issue is whether deceptive behavior or quasi-ethical behavior is allowable. For example, if the buyer decides to tell the seller they do not have a trade in or in response to the question says “no” when in fact they do and plan to introduce that aspect at a point later in the negotiations. These questions, in particular the determination of what constitutes acceptable or ethical behavior (for parties on both sides) is likely to elicit many different perspectives from students and fuel some interesting discussions.

2. What do you expect the behavior of the sales people to be when Michelle and the Lacey's visit the Toyota dealerships?

Drawing on the experiences of students and depending on their levels of expertise, expected behavior may run the gambit from a “hard sell” i.e. strong pressure to buy, and a pressure to buy from inventory currently featured or on the lot, a manifest desire on the part of the sales staff to reach an agreement before the potential buyers leave the showroom, and incremental investment efforts such as to take a test drive, to a discussion of the buyers needs, price range, etc. A discussion of this issue prior to the students/class developing a negotiation plan increases the likelihood that they will develop a more well thought out plan.

3. Develop a negotiation plan (i.e. characteristics of opening offer, reservation price, tactics, tradeoffs they should make, how to react if the seller brings up issues before you are ready to discuss them, e.g. whether you have a trade in vehicle, etc.). Do you have a Plan B if your original plan becomes untenable?

According to many negotiation sources related to automobile buying, unless there are extenuating circumstances such as a vehicle in high demand and limited availability (e.g. Dodge Viper), the buyer's reservation price should be the MSRP (Manufacturer's Suggested Retail Price). The wholesale price, the amount paid by the dealer for the vehicle, could be the target/aspiration price. More realistically however, the aspiration price should be several hundred dollars above the wholesale price. With the buyers' bargaining range determined, an opening offer closer to the aspiration price is typically called for. Given that the buyers already have determined the precise configuration they want and the fact that the markup on accessories is higher than for basic equipment, they can initially represent the configuration they want as one that has fewer options. By doing so, they allow room to “give in” and add other options, ones they want anyway and that have higher profit margins for the seller. A variant on this strategy is to initially represent the configuration they want and including more options than they really want to purchase. Then, in response to an offer of a price, they buyers can propose omitting unwanted options as a means of bringing the price down. Invariably students, particularly ones with limited experience, will develop a plan that is, for lack of a better term, linear. It may assume that the process will go from point A to point B and so on. Most will not have the foresight to plan for contingencies such as the seller jumping from point A to point G, mitigating whatever particular advantages or perspectives the buyer was hoping to introduce. From the seller's perspective they may want to determine whether the buyer is a potential sale as quickly as possible. The issue of when to take a test drive for example, may be introduced by the seller early on, or earlier than the buyer had planned. The presence of contingencies in the students' plans illustrates a richer

understanding of how negotiations such as this occur in practice. If they have a secondary plan (or Plan B) if they determine that the original plan is fundamentally flawed and not appropriate, even with contingencies, for them to continue – they are indeed very prepared. A Plan B could be invoked if the buyers decide for whatever reason that they do not want to deal with the salesperson or dealership (e.g. determining that they are lying on some information, treated particularly badly) or some aspect underlying their original plan has changed (e.g. one of the two buyers pulls out of the agreement to purchase two vehicles at once).

4. What do you believe the salespersons' negotiation plan will be? How can you determine what their plan is?

For many younger students, in particular freshmen, they may have little to no experience in negotiations such as these. Consequently, they may have not considered the preparation of the other side; their goals, needs, trade-offs, etc. in a negotiation. It was Abraham Lincoln, reflecting on his careers as attorney, politician, and President that said when negotiating he spent 1/3 of his time thinking about what he wanted and 2/3 of the time thinking about what the other side wanted; and looking back on it he should have spent more time thinking about what the other side wanted. That perspective, attempting to more fully understand the other party to a negotiation, is one that will benefit students as they analyze and then formulate their own goals, strategies, and tactics.

Instructors may want to assign different students to different tasks – half developing the seller's negotiation plan and half the buyers' plan. These documents could then form the basis for in-class role play experiences or critiquing for the class as a whole.

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CONFLICT MANAGEMENT: THE TEAM NEW ZEALAND CASE

Robert Gilmour, Manukau Institute of Technology
Victoria Wise, University of Tasmania

CASE DESCRIPTION

The primary subject matter of this case is the effectiveness of risk management strategies associated with the staging of a major international sporting event. A secondary issue examined in the case concerns the proprietary rights of employers to the intellectual capital and skills acquired by employees. The case requires an understanding of strategic risk management and good corporate governance principles.

This case has a difficulty level that makes it most suitable for senior level students in a Corporate Governance/Business Ethics course. The case is designed to be taught in three class hours and would require about eight hours of out-of-class time which includes reading the case material and the articles listed in the references.

CASE SYNOPSIS

Team New Zealand (TNZ) is a syndicate that specialised in defending the title to a major international sporting event, the America's Cup Yacht Challenge (America's Cup). The America's Cup is on a comparable level with Formula One motor racing. Title to the America's Cup is usually challenged and defended in the home waters of the title-holder nation. The implications for the title-holder's national economy are significant and positive, particularly for its tourism and boat-building industries. In early March 2000, TNZ successfully defended its title to the America's Cup. By the end of March the contracts of all TNZ team members had expired and the sailors and boat designers were facing an uncertain future. The yacht skipper, the tactician, and four other long-time sailors, all unbeaten in two America's Cup Yacht Challenges, joined a competitor syndicate, the Swiss challenger, Alinghi. As well as their considerable crewing ability, these ex-TNZ team members took with them considerable knowledge of the design of the 2000 America's Cup winning boat. TNZ was left without an overall leader responsible for balancing the needs of boat development and sailing. The TNZ syndicate failed in its defense of the America's Cup in the 2003 Challenge, losing all races in a series of five to Alinghi.

This case focuses on some of the many challenges encountered by management of the TNZ syndicate in mounting their defense in a highly competitive environment, and their ability to choose the appropriate organisational structure and personnel necessary to meet those challenges. The

initial task for the student is to review the current organisational structure of the managing syndicate along with the challenges and opportunities it faces. Students can then use the details provided in the case information and references to develop risk management and corporate governance strategies for success in an environment characterised by uncertainty.

INSTRUCTORS' NOTES

Recommendations for Teaching Approaches

The teaching proceeds by instruction in the principles and practice of good corporate governance and the nexus with the audit function and process. Case study analysis is used to demonstrate the principles and practice in a realistic setting. Case study analysis provides the student with an opportunity to critically analyse the weaknesses and opportunities within a contextual setting and to offer considered solutions. It also affords the student an opportunity to develop team skills by discussing the relevant issues with colleagues and peers within a classroom setting.

DISCUSSION QUESTIONS

These questions cover issues raised in the case study material and the references on the Team New Zealand Challenge for the America's Cup, and the principles and practice of good corporate governance.

1. List the reasons for the failure of the 2003 America's Cup defense by Team New Zealand. Use the following headings:

Reasons for the Team New Zealand failure to defend the America's Cup in 2003 include the following:

Preparation:

- Equipment failure on the test boat.
- The testing program for the race boat was not complete before the commencement of the matches.
- Insufficient time was spent practicing in the adverse weather conditions likely to be encountered during the race period.

Design:

- The race boat was a designers' boat (theoretically sound) rather than a sailors' boat (practical).

-
- The race boat was not designed to race in the conditions that it was subsequently raced in.
 - The designers gambled on weather conditions (good breeze, calm conditions) that did not prevail.
 - The radically new design consumed too much time and resources.
 - Boat-builders' (expert) concerns were ignored.
 - The management structure was design dominated with insufficient balance between design and sailing.
 - The sailors lacked confidence in the boat design.

Conflict of interest:

- Beneficial ownership of the Team New Zealand Trust was unclear leading to distrust and speculation about management motives.
- Sailors and other team members were obliged to sacrifice loyalty to Team New Zealand when faced with economic uncertainty.
- Team New Zealand had an insufficient budget to allow it to fully test the training boat as it did not have the financial capacity to replace the training boat should it become damaged. If the training boat was not available, there was no other boat available against which the race boat could be tested.

Intellectual capital:

- The trustees of Team New Zealand did not have proprietary rights to intellectual capital acquired by the sailors and other team members.
- Team New Zealand lost the intellectual capital acquired by the sailors and other team members who had accumulated boat-performance and boat-handling experience to a competitor (the Swiss challenger, Alinghi).
- Team New Zealand lost design information from the previous (2000) America's Cup challenge.
- Team New Zealand lost substantially all of its key decision makers to a competitor (the Swiss challenger, Alinghi).
- Team New Zealand lost the synergistic intellectual capital associated with a 'unit' of sailors and team members who had cooperated together successfully in previous America's Cup challenges.

Corporate governance:

- Team New Zealand lacked a sound corporate governance structure.
- There was a lack of risk management systems.
- After the successful 2000 campaign, the TNZ management team failed to resolve the protracted conflict with its key personnel.

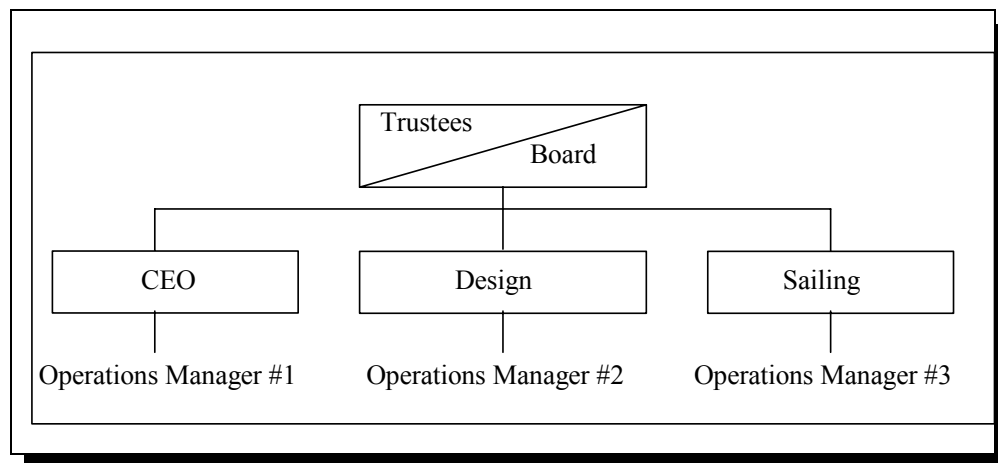
- Team New Zealand failed to secure the ongoing services of its sailors and team members who had accumulated successful America's Cup Challenge experience.
- TNZ management failed to assign overall responsibility and authority to a single director.
- TNZ management failed to assign overall operational responsibility to a single individual.

Other:

- Another competitor (the successful challenger, Alinghi) was battle-hardened and fully prepared after adequate training.
- The designers failed to accept the advice and warnings of scientific academics and experienced boat-builders who warned against aspects of the new boat design.

2. Prepare an organization chart that demonstrates the system of corporate governance used by Team New Zealand for the 2003 defense campaign.

An example of an organisation chart demonstrating the system of corporate governance used by Team New Zealand for the 2003 defense of the America's Cup.



3. Consider the conflict between the existing Board of Trustees of Team New Zealand and two critical employees, Coutts and Butterworth, and discuss the behavioural influences on the decision making of both parties. Suggest strategies to manage and/or resolve such conflict.

The conflict between the two parties (the Team New Zealand trustees, and the employees Coutts and Butterworth), resulted from the apparent reluctance of the trustees to relinquish control of the Team New Zealand syndicate to the employees and the frustration the employees experienced from lack of information and the apparent intransigence of the trustees. Both parties potentially viewed themselves as disadvantaged – the trustees if the proposed changes occurred, and the employees if the proposed changes did not occur. The negotiations between the parties continued for two years before abruptly ceasing. Commonly this situation is called escalating commitment; often managers let this situation overwhelm them and end the process by ‘quitting’.

Effective strategies to manage and/or resolve such conflict are likely to include:

- Set advance limits on management involvement and commitment to a particular course of action, and stick to these limits.
- Individuals should make their own decisions; following the lead of others is prone to escalating commitment.
- Carefully determine why a course of action is being pursued; if there are insufficient reasons to continue, don’t.
- Determine the cost of following a particular course of action; consider the cost savings as a reason to discontinue.
- Watch for escalation tendencies; be on guard against their influence on all parties involved in the conflict.

(Adapted from Schermerhorn et al, 2004 p.80).

4. Discuss how the corporate governance structure may have contributed to the failure of the 2003 America’s Cup defense.

The most critical weakness appeared to be that no single individual had a total overview or responsibility for decision-making in relation to the development and preparation of the 2003 America’s Cup challenge. The management structure was inadequate to deal with the sudden departure during March – May 2000 of a substantial portion of the experienced crew and other team members. The business structure lacked continuity of management. It was designed to handle one campaign at a time in an ad hoc fashion.

5. Identify the changes that would be required for the Team New Zealand management to comply with current corporate governance best practice.

The corporate governance structure at Team New Zealand during 2000 – 2003 can be criticised for not complying with best practice. In particular a risk management system

had not been established. This meant that the preparation for the America's Cup defense was not monitored. There was no evidence that the preparation for the defense was reported to management or that remedial action occurred to correct deficiencies in the preparation. Changes that could be introduced to strengthen the corporate governance structure include:

- The appointment of a manager charged with overall authority and decision-making.
- The establishment of reporting lines flowing vertically from operational levels to executive levels.
- The implementation of a risk management process/system.
- The establishment of an audit committee and an internal audit function.

6. State two beneficial outcomes that a future Team New Zealand challenge is likely to enjoy as a result of establishing an audit committee.

Two beneficial outcomes that a future Team New Zealand might enjoy as a result of establishing an audit committee could include:

- The audit committee would review the process of assessing risk
- The audit committee would monitor operational and financial activities.

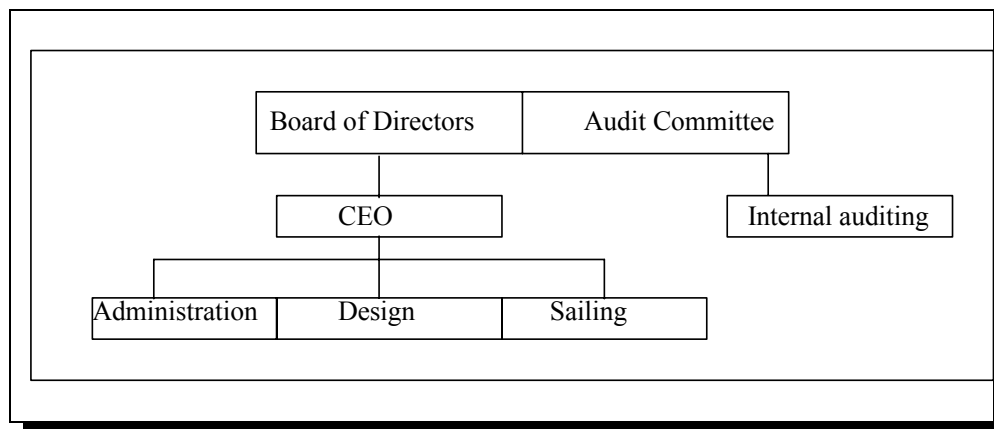
7. State two beneficial outcomes that a future Team New Zealand challenge could obtain from establishing an internal audit function.

In response to this question, students should be encouraged to discuss the following events or actions that are likely to lead to beneficial outcomes:

- Independent appraisal and reporting on operational, financial and riskiness of the defense campaign
- Examination and determination of the efficiency and effectiveness of corporate governance and risk management systems.

8. Prepare an organisational chart for a new Team New Zealand management structure that incorporates an audit committee and an internal audit function.

An example of an organisation chart for a new Team New Zealand management structure that incorporates an audit committee and an internal audit function appears below.



9. **Discuss the limitations of the Report on the Team New Zealand failure prepared by a trustee of Team New Zealand and provide reasons why a report prepared by an internal auditor might have more credibility.**

In dealing with this question students should be encouraged to discuss at least the following limitations:

- A report on the actions/achievements of a trust by a trustee who is associated with that same trust cannot be regarded as independent.
- A report that is not independent may be biased.
- A report that is not independent may have important omissions.

10. **Prepare an audit findings schedule for the Board of Team New Zealand assuming that an internal audit has confirmed that the Team New Zealand failure was caused by non-compliance with corporate governance best practice and in particular the absence of a risk management system. Use the accompanying schedule and include it with your answer.**

Audit findings schedule assuming the internal audit has confirmed that the failure to successfully defend the 2003 America's Cup was attributable to non-compliance with corporate governance best practice and in particular the absence of a risk management system.

Audit Findings Schedule		
Finding Attribute	Definition	Example from the question scenario
Criteria	The standard measures or expectations used in making an evaluation and/or verification (what should exist)	Current best practice requires governing bodies to have appropriate systems in place that will report internal control deficiencies to the board of directors.
Condition	The factual evidence which the internal auditor found in the course of the examination.	Team New Zealand trustees seemed to be unaware of the problems occurring in the preparation for the defense.
Cause	The reason for the difference between the expected and actual conditions (why the difference exists).	Team New Zealand did not have a risk management system that reported problems to management and/or the trustees.
Effect	The risk or exposure the auditee organization encounters because the condition is not the same as the criteria.	Team New Zealand started the first race unaware of the extent to which the race boat was unable to cope with adverse weather conditions.
Recommendation	That the new management structure for Team New Zealand include risk management systems that are reviewed by an internal audit function that reports to an audit committee of the board of directors.	

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RYANAIR (2005): SUCCESSFUL LOW COST LEADERSHIP

**Thomas M. Box, Pittsburg State University
Kent Byus, Texas A&M University – Corpus Christi**

CASE DESCRIPTION

The primary subject matter of this case concerns strategic management in the airline industry in Europe. Secondary issues examined include international marketing, operations management and business ethics. The case has a difficulty level of four or five, and the case is designed to be taught in one 90-minute class session. It is expected that students will need to devote three to four hours of outside preparation for the class discussion.

CASE SYNOPSIS

Ryanair is a 20-year-old international air carrier based in Dublin, Ireland. It is now the largest low cost airline in Great Britain and Europe and has modeled its operations (since 1991) on the very successful Southwest Airlines Low Cost Leadership model. Ryanair's CEO, Michael O'Leary, is an accountant by training but a combative entrepreneur by inclination. He has angered trade unions, government officials and competitors with his "bare knuckle" tactics but has achieved dramatic growth and profitability in the very competitive airline industry.

As of the end of the year 2004, Ryanair was flying 25 million passengers annually with a staff of less than 2,500 personnel. Ryanair flies only Boeing 737s and is rapidly transitioning to the newest 737 models – the 737-800. Challenges to the airline at the end of 2004 included escalating fuel costs, intensity of competition and the sometimes less than favorable attitude of the regulatory bodies in Great Britain, Ireland and the EU.

INSTRUCTORS' NOTES

Learning Objectives

This case is intended to reinforce strategic management concepts at the senior-level or first year MBA level. The following common tools can be employed in a discussion of the case.

1. Porter's Generic Strategies
2. SWOT analysis

3. Porter's Five Force Analysis of Industry Competition
4. Pricing strategies
5. Market expansion

It is assumed that most of the above topics will have been discussed in class prior to the case analysis. If not, then this case provides a real opportunity for the "blackboard panel approach" recommended by Harvard Business School.

Teaching the Case

We suggest that a common starting point for this should be a classroom discussion of SWOT analysis and generic strategies. This case is an interesting example of the differences between firms well-known for employing a particular generic strategy, in this case Low Cost Leadership. Despite the fact that Ryanair emulated Southwest Airlines' approach to business, there are substantive differences between the two firms. Ryanair's O'Leary and Southwest's Kelleher are vastly different in their approach to customers and employees. It should be explained (particularly to undergraduate students) that a Low Cost Leadership strategy doesn't necessarily mean a low selling price for products and services.

When assigning this case for an in-depth classroom discussion, we have found it helpful to require students to jot down answers to the discussion questions prior to class. This facilitates the discussion and also helps to eliminate the "free rider" attitude of some students who don't prepare by reading the case.

In addition to the following discussion questions, one could easily include other topics and, perhaps, stretch this to a two-day discussion. Other topics might include:

1. The differences and importance of remote industry environmental factors like fuel cost, regulation and the potential impact of terrorism.
2. A discussion of Kelleher (Southwest Airlines) and O'Leary (Ryanair) and their substantial differences regarding what the Quality Management people call "The Voice of the Customer."

DISCUSSION QUESTIONS

1. Do a SWOT analysis for Ryanair at the end of 2004.

Strengths for Ryanair include continuing profitability and revenue growth despite intense competition. Additionally, their business model – very similar to Southwest Airlines – is also an apparent strength.

Weaknesses would include the reputation they have for less than competitive customer relations and employee relations.

Opportunities for Ryanair include expansion of their routes to Eastern Europe.

Threats continue to be the escalating cost of fuel (a major component of operating expenses) and competition. It might also be argued that relations and interactions with the Irish and EU governments constitute at least an implicit threat.

2. As specified in the case, Ryanair and particularly Michael O’Leary have been criticized regarding business practices. Using the following terms, discuss Ryanair’s ethical decision making.

- a. Applied ethical standards:**
- b. Above the law:**
- c. Aspirational:**
- d. Beyond the bottom line:**

- a. Business ethics is more and more becoming an applied discipline. Most all professional fields have engaged in rule making and standard setting that are derived from moral philosophy or religious tradition. Ryanair, as part of the international airline industry, must consider the application of specific ethical criteria if it is to continue to grow and prosper in an expanding global marketplace.
- b. Ethical decision criteria are typically those that are above the legal minimum. Unfortunately, many companies, Ryanair perhaps, view ethics as synonymous with legal requirements. Business should (normative) view the law as the floor and not as the ceiling.
- c. Ryanair, like Southwest Airlines, should consider ethical standards to be inspirational as well as aspirational. Junior and senior executives should (normatively) approach business decision making within a virtuous framework. In addition to formalizing a vision and mission, Ryanair might consider formalizing an “Aspiration Statement”.
- d. Ryanair should (normative) view growth within the conditions that are beyond financial impact. Environmental, safety, and societal implications of decision

making and policy setting provide greater long-term benefit than merely providing low-cost operations that benefit shareholders. Ethical decisions must be systematic and transparent for customers, stockholders, employees, and other vested stakeholders.

- 3. Achieving financial critical mass, that is, the minimum size of the firm thought necessary to compete effectively is critical to Ryanair's continuing success. What issues associated with Ryanair's financial performance and strategic growth plans present concern to the analyst when considering the critical mass issue?**

A major reason why companies seek to achieve critical mass is because the market will very often place a higher multiple on the earnings of a larger company compared to those of a smaller company. In the case of Ryanair, if the acquisition of new aircraft or new routes and destinations dilutes the earnings of a business, then it could reduce value, even if the business has doubled in sales and carries a higher multiple. In addition, it is a dangerous proposition for any public company to make business decisions that are tailored to the investment community where opinions can be fickle. Specifically, the analysis of Ryanair's financial performance should be considered in terms of the critical ratios that will be impacted by any large scale addition of equipment, employees, or additional costs, especially when competing with airlines that receive subsidies from national treasuries.

This assumption that bigger is better needs to be examined critically. Exactly why is bigger better? There are scores of strong, profitable, well-managed companies that have lower than average sales in the airline industry. There is also a history of acquisitions of these types of businesses by larger companies that squash the very culture that makes the business so strong in the first place. Once again, a strategy to achieve critical mass in the operational sense also needs to be challenged and understood before acquisitions, equipment or routes are pursued.

- 4. Difficulties in implementing international coordination and growth may be traced to the inherent problems of developing a compatible organizational culture within the cultures of otherwise disparate national cultures. Ryanair's growth plan requires significant understanding and integration of such cultural differences. Discuss the following internal/organizational issues that must be more specifically addressed to insure Ryanair's long-term success.**
- a. International Career Paths:**
 - b. Management Training:**
 - c. Reward Systems:**

d. Management Recruitment:

e. Information Systems and Technology:

- a. Management promotion within an international organization typically includes a plan to systematically assign managers to international posts. In Europe, such path assignments produce requirements to ensure that managers can learn new languages, adapt to succession, and develop specialized decision making skills.
- b. Training at all employee levels must include exposure to similar techniques and methods that are designed to help promote standardization and the development of a uniform company identity. Personal relationships, communications, formal and informal training schedules, and unionization are a few of the critical items to be considered by Ryanair.
- c. Compensation, bonus payments, time-off and benefits are generally bounded by a national mentality. Ryanair must consider all such implications.
- d. Nationality and other characteristics of Ryanair's pool of managers will have an important bearing on the firm's internal environment and ultimate strategic success. Significant resentment and counterproductive behavior develops within organizations when executive management of a limited national source allows operational activities to be undertaken by locals with another national identity.
- e. The ability for employees and managers to identify with the aims and goals of Ryanair will depend on the nature and scope of information available. In cases where information flow is one-way (provided to an international headquarters with little or no corresponding return flow), management will find it difficult to aid in the organizational culture creation.

5. Are there any strategic management lessons that Michael O'Leary could learn from Herb Kelleher (Founder and CEO of Southwest Airlines) as Ryanair pursues its growth plan?

"*The Leader to Leader Institute*" (formerly the Drucker Foundation, 320 Park Ave., 3rd Floor, New York, NY, 10022) profiled Herb Kelleher and discovered some specific and important characteristics and attributes that could be of benefit to Michael O'Leary as he ponders his "yellow legal pad issues." They include:

- a. When building a culture of commitment and performance spend less time benchmarking best practices and more time building an organization in which personality counts as much as reliability.
- b. Don't just lead by the numbers. Business must be fun. Hire people who have humor during the bad times because when they come to work, they will help make the firm different and better.
- c. Don't be afraid of losing control of the organization. Create an organization where people truly want to participate and you will not need control.
- d. Rather than trying to define what the customer will do, define what the firm is and what is important.
- e. Make a commitment to job security and customer satisfaction that cannot be matched by the competition.
- f. The most important training is not how to manage or administer but how to lead.

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MICHAEL EISNER AND HIS REIGN AT DISNEY

Meredith Downes, Illinois State University

Gail S. Russ, Illinois State University

Patricia A. Ryan, Colorado State University

CASE DESCRIPTION

Topics addressed in this case include management conflict, corporate governance, shareholder value, and CEO succession. It may be used in an undergraduate, upper-level classroom, and is particularly appropriate for a capstone course in strategic management. It will also work well in any number of graduate business courses, including general management, leadership, and organizational behavior. Prerequisites for this case include some understanding of prevailing corporate governance topics, as well as familiarity with The Walt Disney Company's diversified portfolio of businesses. As a result, no outside readings should be necessary to understand the case, but some outside research will be necessary in order to address the assigned questions. The case should prove to be an easy read, taking no more than 20 to 30 minutes and then allowing 1 ½ to 2 hours to address the questions that follow.

CASE SYNOPSIS

This is a story of the triumphs and challenges of one of the most notable executives in corporate American history, Disney Chairman and CEO Michael Eisner. The purpose of this case is to highlight the impact of corporate governance from a shareholder perspective. In particular, two problems are addressed – (i) Disney's reputation for weak governance, whether justified or not, and (ii) dissent among the top ranks of the organization. While it is difficult to determine which came first, the case shows how each of these issues perpetuates the other, and that removing the source may be the only way to recover. As CEO, Michael Eisner was blamed for both, and thus the board was divided into two camps. There were those who supported Eisner and his actions over the years and those who did not. The question remained as to which side would prevail.

The case begins with a description of the situation facing Eisner at the close of 2003. Two long-standing Disney board members had called for his resignation from both positions, in letters rife with criticism of Eisner and his management team. Eisner's many options are presented and revisited later in the case.

In order to help the reader analyze Eisner's situation, the case provides a brief history of The Walt Disney Company, as well as biographical descriptions of the CEO and the two dissenting board members, Roy Disney and Stanley Gold. Coverage includes company milestones under

Eisner's leadership, and comparisons are made between the company's financial performance and Eisner's highly criticized compensation package. We then describe the conflict that arose between the parties and offer some discussion of the governance practices that come under attack in the letters.

As there are usually two sides to every story, voices in favor of Eisner's management are also heard. The case then discusses what transpired as shareholders met and voted on a key governance issue with clear implications for the future – both for Eisner and for the company and its shareholders.

INSTRUCTORS' NOTES

Assigned Questions

- 1. Who served on Disney's board of directors in 2003? Describe the characteristics and backgrounds of each board member.**

The following table lists those directors of the Walt Disney Corporation who were up for reelection in 2003, along with their ages, tenure on the board, whether they were considered to be insiders to the company, and how many directorships they held in 2003 in addition to Disney.

	Age	Tenure on Board	Insider/ Outsider (I/O)	# of other directorships
John E. Bryson	59	3	O	4
Roy E. Disney	73	36	I	1
Michael D. Eisner	60	19	I	0
Judith L. Estrin	48	5	O	2
Stanley P. Gold	60	16	O	2
Robert A. Iger	51	3	I	1
Monica C. Lozano	46	3	O	6
Robert W. Matschullat	55	1	O	2
George J. Mitchell	69	8	O	3
Thomas S. Murphy	77	7	I	1
Leo J. O'Donovan, S.J.	68	7	O	0
Raymond L. Watson	76	29	O	1
Gary L. Wilson	63	18	I	5

While only 5 of the 13 directors were considered insiders, as defined by their employment, past or present, with the Walt Disney Company or any of its affiliates or acquired companies, others may have had relationships with the company that extended beyond their directorships. These directors, therefore, while considered outsiders, may not meet the standards of independence as set forth in the company's guidelines as well as by the new governance legislation. Examples include Senator George Mitchell's architectural services rendered to the company, as well as Louise Bryson's (wife of director John Bryson) employment at Lifetime Entertainment Television, in which Disney has a 50 percent stake. The age distribution on the board indicates that several board members were upwards of 60 years old, and we can also see that many board members had considerable tenure. In fact, committee memberships changed very little over the 5 years prior to 2003, providing some indication of entrenchment, which has been said to lead to stagnation and inertia.

2. Why do you suppose the Board of Directors was so unwavering in its support of Michael Eisner?

To begin with, until the time that Senator Mitchell became the new Chairman of the Board in 2004, Eisner served in both the Chairman and CEO capacities. It is no wonder that he would be supportive of his own decisions and actions. As for the rest of the board, there were considerable conflicts of interest that may have prevented board members from speaking out against Eisner, even when this would have been in the best interest of the shareholders. As mentioned in the case, several directors had children employed by the company, and may have perhaps been fearful for their jobs or even their back-pay, severance, or other pensions that may have been due in the event that their employment at Disney had ended. Other board members also depended on Eisner and/or the company, in that Eisner's sons attended their schools and may have feared some backlash in terms of contributions to the school or even the school's reputation, if they were to disagree with Eisner. Students may suspect that there were several such conflicts, although not mentioned in the case. Among them are the following, as found in the Disney Proxy Statements from 1999 to 2003:

Robert A.M. Stern Architects, of which Disney director Stern is Senior Partner, was retained by the Company for a variety of architectural services to Disney and its license and other affiliates. Among these were Oriental Land Co., Ltd, which owns and operates Tokyo Disneyland, and Euro Disney S.C.A., the French company that owns and operates the Disneyland Paris Resort, as well as a new resort development at Walt Disney World in Florida. Stern's firm received the following from either Disney or its licensees for services rendered: \$459,963 in 1998; \$71,731 in 1999; \$318,562 in 2000; \$76, 513 in 2001; and \$105,668 in 2002.

Senator George Mitchell provided consulting services to The Walt Disney Company with regard to international business operations and development efforts, and for services rendered received \$50,000 in each of the years from 1998 to 2001. In addition, the Company retained the law firm of Verner, Liipfert, Bernhard, McPherson & Hand, of which Mitchell was special counsel, and paid the following for services rendered: \$766,020 in 2000; \$1,279,425 in 2001; and \$442,872 in 2002.

In 2002, Louise Bryson, wife of director *John Bryson*, served as Executive President-Affiliate Sales and Marketing for Lifetime Entertainment Television, in which Disney has a 50 percent equity stake. She received \$386,483 in salary and allowances for the year

Air Shamrock, owned by Shamrock Holdings, Inc., received \$623,782 in reimbursement for the use of its aircraft in 2002. Specifically, travelers included director Roy Disney and those directors and employees who accompanied him. Director *Roy Disney* is both a director and owner (along with his family) of Shamrock Holdings, and director *Stanley Gold* is President and CEO of Shamrock Holdings and is a director of Air Shamrock.

Eugene Bay, father-in-law of Disney President and director *Robert Iger*, is a principal of Eugene Bay Associates, Inc., a marketing company that was retained by Disney subsidiary ESPPN since 1990 to provide sports marketing services. Mr. Bay's company received \$69,892 for services provided in 2002.

3. Evaluate the options that were available to Eisner. What factors do you think he considered when weighing his alternatives?

Eisner could have heeded the wishes of Roy Disney and Stanley Gold by resigning both of his posts. In doing so, though, he may have satisfied some stakeholders while displeasing others. Institutional investors, for example, have been quite vocal about the dysfunctionality of the Disney board, and Eisner's removal may have quieted them. With corporate image intact, this may have enhanced Disney's ability to attract new investors, as well as regain existing shareholder confidence, thus having a positive effect on share price. However, before these long-term benefits are realized, the company was likely to have endured a bitter board, as there is no mistaking the board's overwhelming support of Eisner. Further, new management or chairmanship may not have seen eye-to-eye with the existing board members and thus the directors' seats on the board would be at risk. Eisner could, of course, have resigned his chairmanship but remained as CEO. This would have compromised very little for Eisner, as the gesture would go a long way with institutional and other investors while at the same time allowing Eisner to run the company with the same supportive board and with a new chairman who is likely to be selected from among those directors. This, of course, became the decided course of action, but at the discretion of the board and in response to the shareholder vote in favor of splitting the two roles. With only

the CEO position left to contemplate, one can only speculate as to the factors that went into Michael Eisner's ultimate decision to retire upon reaching the end of his contract.

4. **Compare Michael Eisner's current compensation package to the company's recent performance. Was his pay justified? Why or why not? In answering this question, consider the following:**
- a. **How have other CEO's been compensated in relation to their company's performance? Look at CEO's of competitor companies or of similarly diversified firms.**
 - b. **Based on your finding for (a) above, would you say that there is some minimum level of compensation that is necessary to attract and retain high-quality corporate leadership?**

Although Disney's performance in the last year has begun to improve, the six years prior to that time have been hard ones for Disney investors. While revenues increased by 17.8 percent, this may have been due to the diversified nature and many holdings of The Walt Disney Company, because profits over the same period declined by 20 percent. Further, since the last split, the price of common stock has dropped by nearly 40 percent. Eisner, on the other hand, has one of the largest pay packages awarded to any CEO. Although his stock options and stock ownership suggest that his interests should be tied to those of other shareholders, Disney has compensated Eisner over one billion dollars since he became the Disney CEO. Students may speculate that it is Eisner's ego and desire for a positive legacy for his Disney years, more so than his wallet, that will ensure he tries to turn Disney around.

In assigning this question, you may wish to engage the students in a discussion about which firms should be selected as comparison companies for Disney. This is a valuable exercise for students as it also can serve to acquaint them with the SEC website, a resource often overlooked or unknown by college students, as well as introduce them to company proxies and 10-Ks.

TIP: You can find companies' financial filings (such as the 10-K, the annual financial statement required by the SEC) on the SEC website at www.sec.gov. Click on "Search for Company Filings" under the banner labeled "Filings & Forms (EDGAR)." Under the General Purpose Searches banner, click on "Companies & Other Filers." You will need to fill in the company's name, and you should note that this official SEC website can be finicky about how the name of the company is entered (e.g., you must enter "Walt Disney," not just "Disney"). This is a valuable website that has annual and quarterly reports, as well as the company's proxy statements (where CEO and other top executives' compensation is typically discussed), and all other official documents filed with the SEC.

Although individual companies often make their most current 10-K available on their own website, older ones are not often available there, but on the SEC website you will be able, in most instances, to access documents filed from 1994.

5. Evaluate the conflict among the board members from a shareholder's perspective. What impact might the conflict have on investor confidence?

Any dissension at the top of an organization could weaken investor confidence in the organization as a whole. In-fighting could lead to indecision, and opportunities could be lost in the process. Further, conflict could create a sense of anarchy in the minds of shareholders. If board members are heavily criticizing the key decision-maker in the organization, then shareholders may begin to question the CEO as well, and may think twice about re-investing in Disney, or worse, may even consider divesting Disney stock from their portfolios. As an alternative strategy for instilling investor confidence, Eisner could have forfeited or donated a good portion of his salary, created a self-imposed ceiling on his pay, or suspended any increases in compensation until the company's performance improved. This would have allayed any misgivings that investors and other interested parties may have had about Eisner's intentions or priorities. Eisner's attempt to restore the company's reputation by hiring Ira Millstein, the governance specialist, may be seen as a positive gesture toward complying with governance guidelines and may thus instill investor confidence. However, shareholder activists and board dissidents question his motives and also his creative definitions of board independence. Stanley Gold, for example, was deemed not to be independent based on his close relationship with Roy Disney. This cost him his position as chair of the powerful Governance and Nominating Committee. Robert A.M. Stern similarly was not independent because of architectural services that he had been providing to Eisner, although Stern retired from the board in 2003. However, Sen. George Mitchell, the other fees-for-services recipient, was curiously deemed independent and ultimately became the new Chairman of the Board.

6. Evaluate the conflict among the board members from a stakeholder perspective. What impact might the conflict have on claimants other than the shareholders?

Employees: Morale is likely to have deteriorated in the face of dissension in the upper echelons. Eisner had been accused of micromanagement, and according to Roy Disney, "he ran a very repressive regime." Mr. Disney has said that Eisner was continuously making unilateral decisions. Regardless of their truth, such accusations are likely to bear negatively on the employees.

Customers: In Roy Disney's resignation letter, he refers to the company's theme park investments as "timid". He suggests that Eisner has tried to build theme parks "on the cheap" in California, Paris, and Hong Kong, and that this is reflected in the attendance levels at the park.

Partners: There has been some difficulty in building effective relationships with Pixar and the Disney-owned but independently run Miramax Films. These difficulties have come to the forefront in the midst of the conflict between Eisner and the two board dissidents. They have also highlighted Eisner's failure to build constructive relationship with the cable companies that distribute the many Disney products.

Sponsors/Advertisers: Disney-owned channels, such as ABC Prime Time and ABC Family Channel, have suffered in the ratings, and Eisner's opponents also criticize him for poor programming. This could certainly turn advertisers away, in addition to having an adverse impact on shareholder value.

7. **Describe the leadership characteristics of Robert Iger, Michael Eisner's successor. How might certain stakeholders view Iger, as compared to the long-reigning Eisner? (HINT: Consider relationships with the Walt Disney Company that may have deteriorated during Eisner's tenure).**

Robert Iger, a magna cum laude graduate of Ithaca College, has had a history of professional successes. He began his career at ABC in 1974 where he held a series of increasingly responsible senior management positions. Iger oversaw ABC's broadcast television network and station, cable television, radio and publishing businesses. He rose to the rank of President and COO of Capital Cities/ABC, during which time he guided the merger of ABC with The Walt Disney Company. In 1999, he became President of Walt Disney International, and in 2000 became President and COO of The Walt Disney Company. Iger also joined the Disney board, and together with Eisner, oversaw all aspects of the company's worldwide operations including its filmed entertainment, theme parks and resorts, media networks and consumer products businesses. Iger was elected by the Board to succeed Michael Eisner as Disney's CEO in March 2005.

Many were skeptical of Iger, who was hand-picked by his predecessor and thus may not be inclined to make decisions independent of Eisner. However, some bold moves have shown otherwise. Some employees, appointed by and perhaps cronies of Michael Eisner, have either been reassigned or fired. Their dissatisfaction may be countered by other shareholders who see Iger's actions as clearly making a clean break from Eisner and as being the start of a new era. Further, he disbanded Eisner's centralized Strategic Planning Division

in order to give decision-making authority back to the individual business units. He was able to reconcile the company's differences with Mrs. Disney and Gold, who then dropped their SaveDisney campaign and agreed to work with Iger. He also appears committed to providing top-quality animation. He repaired the damage done between Disney and Pixar, with whom Disney was to no longer be working on animation projects. In fact, under Iger, Disney not only continues to work with Pixar but has acquired the company and has placed CEO Steve Jobs on the Company's board.

8. Roy Disney and Stanley Gold criticized Michael Eisner for his lack of a clear succession plan. Under Iger, has one been established? If so, what does it state?

Complaints of Eisner's succession plan were numerous. It was said that Michael Eisner had in his possession an envelope which contained his succession plan – the name of a single successor. He was not to attend successor interviews, which were to be conducted through an independent process by Chairman of the Board George Mitchell. Roy Disney became very dissatisfied upon learning that Eisner would indeed be in attendance at all interviews, although only one candidate was under consideration.

Under the current Corporate Governance Guidelines, the CEO is required to meet at least once each year with the non-management Directors to discuss his potential successors. Following these meetings, the non-management Directors will then meet in executive session to consider what had been discussed. At all times, the CEO must have in place a confidential written procedure for the timely and efficient transfer of his or her responsibilities in the event of his or her sudden incapacitation or departure, including recommendations for longer-term succession arrangements. He is required to review this procedure periodically with both the Chairman of the Board and the Governance and Nominating Committee. The CEO must also periodically review with the non-management Directors the performance of other key members of the senior management of the Company, including potential succession arrangements for those managers. Any waiver to the Company's Standards of Business Conduct for any member of senior management must be reported to and approved by the Board. As Robert Iger has only recently been appointed as CEO of the Walt Disney Company, it is not publicly known whether he has yet to establish a policy beyond that which is described here, or what deadline has been given by which to name his successor(s).

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INTERNATIONAL MARKETING AND DELIVERY OF BANKCARD PROCESSING SERVICES (TSYS)

John T. Finley, Columbus State University

CASE DESCRIPTION

This case depicts a US-based firm that painstakingly but successfully markets its bankcard processing services to international prospects. The case intends to enable the student to assess how TSYS' success in the European market entry has taken place. Following this assessment, students will study strategic considerations related to the present market attained by TSYS in the United Kingdom and Ireland and the possibility of further expansion of operations internationally. The basic modes of supply are a combination of services supplied from one country to another, corporate subsidiary setup of operations and local personnel recruitment. Prior to the establishment of operations, an extensive discovery, sales and marketing process leading to contract negotiation takes place. The case describes the strategic challenges facing a services firm and the integration requirements necessary for successful market penetration. The case concludes with an overview of the successes enjoyed by TSYS as a result of these efforts and decisions to be made regarding subsequent actions. Although TSYS has developed operations in several regions internationally, the case concerns service delivery to the European market and the potential of further expansion in that market. A firm embarking on such exportation must be cognizant of and form entry strategies bearing in mind the longer sales cycle and a need for direct in-country representation to achieve product awareness. This case is designed for a junior level undergraduate course in International Business, International Marketing or International Strategy in which the above topics may be covered.

The exercise is designed to be taught in a one hour class and is expected to require two hours of outside preparation. The author endeavors to provide an enhanced understanding of bankcard services marketing and delivery with the corporate objective of long-term growth, increased revenue generation and improved market share. Study of the proliferation of services is notably important in light of the continuous augmentation of this type of business endeavor versus manufacturing. According to the 2004 World Investment Report published by the United Nations Conference on Trade and Development, future economic growth improvements will be patent particularly in "the case of services, which make up the largest economic sector in many countries, and which dominate foreign direct investment" (UNCTAD World Investment Report, 2004).

CASE SYNOPSIS

Service industry exportation entails a certain marketing-related complexity not similarly encountered with the export of manufactured goods. TSYS, a processor of bankcard transactions, boasts top notch sales, technical and project management expertise that has effected success in the services marketplace. Having thoroughly penetrated the United States bankcard services market, TSYS set out to explore new and international opportunities through a customized sales approach of bankcard processing service offerings. Just as regulations and other compliance issues vary from country to country, so do processing requirements, rules and other idiosyncrasies of the industry on an international level. The solution to ensure ultimate delivery is shaped by several elements “unique to a services solution that differentiate it from a [tangible] product solution” (Hill, 2003). Speed to market is greatly affected in comparison with that of tangible product offerings. Additionally, estimation and control of the timeliness of deliverables tend to be more elusive thus requiring increasingly skilled management of the process. TSYS’ marketing with regards to cross-border service bankcard provision involved dealing with factors such as intangibility, customization requirements, lack of inventory, time sensitivity and change and quality management. The case is instructional in terms of the challenges such service firms may face and how to respond.

INSTRUCTORS’ NOTES

Recommendations for Teaching Approaches

As this case deals with a credit product that many students own, will own, may use internationally etc., the instructor should strategically segue into the case with a basic overview of the existence of the credit card processing industry and the basic activities taking place with the generation of transactions as portrayed in the case. The credit card processing realm can be presented as the backbone to a system that provides a payment infrastructure that allows for easier payments internationally (e.g. when the students travel be it via study abroad, on business or other form of personal travel). Within an international business course in which barriers to trade are discussed, the credit card and the credit card industry can arouse interest as a mechanism that lowers barriers to trade and commerce in ways as a payment option accepted on a global scale that does not require a multitude of slow processes such as those barriers that exist with the use of traveler’s checks or the costs involved in time and fees when exchanging foreign currency. The case can also be a catalyst to a lively conversation about the existence and circulation of the euro in most of Europe but not in the United Kingdom.

It stands to reason that the average cardholder is vaguely familiar with some of the general occurrences associated with bankcard usage such as the need to swipe the card at certain terminals, receipt of a periodic statement, and the option of disputing transactions. The students are, in many

cases, stakeholders with regard to the product itself and therefore curiosity may be piqued by the possibility of learning a bit more about related operations surrounding the piece of plastic found in many wallets. It is also crucial for undergraduate students to place adequate focus on service industries along side manufacturing industries as a large portion of the graduates may enter the job market in a service providing firm.

CASE QUESTIONS

- 1. Explain some of the factors and challenges TSYS met upon the launch of international expansion into the United Kingdom and Ireland. Discuss the strategies employed in facing the challenges and implications for a service industry manager of an internationally expanding corporation.**

Inherent with bankcard processing is the sensitivity of data. The precision with which data is to be processed is essential in any market related to bankcard processing services. The due diligence required when exploring other markets entails the research of key channels, potential markets, and areas in which to benefit from economies of scale or strategically enhancing processing platforms to economically handle multiple smaller markets. In the case of TSYS as a third party processor (outsourced solution for banks), often has been the case that the larger customers would observe the results of the processing of smaller entities or portfolios and employ a “wait-and-see” approach. A successful observation phase implied higher possibility of signing on the bigger clients or the remaining portfolios of the larger banks.

The sales cycle deals with lengthy contractual discussions and agreements as well as highly coordinated turning over of clients known as the deconversion/conversion process. That is, when a bank changes processor, there is a deconversion (from in-house or other vendor) and a subsequent conversion (in this case, to TSYS) of the live cardholder accounts. The processing of these accounts cannot be placed on hold while outsourcing changes are underway thus the meticulous nature of this process. The longer sales cycle is an aspect of the third part processing environment. The initial discovery and contact with a prospective client until the actual implementation can be from two to five years. Therefore, a manifold-like pipeline is an important strategy for TSYS because having multiple prospects in the pipeline enables TSYS a greater diversification in terms of time and size of the prospects that finally reach a decision.

- 2. How can TSYS determine the value of diversifying into multiple markets beyond the United Kingdom and Ireland? Is there a point at which further expansion becomes detrimental for an individual processing firm? If so, how? Consider the inflows and outflows incurred related to the United Kingdom/Ireland presence from table 10.**

The pricing in the bankcard processing arena is rarely based on a standard worldwide price due to the factors in the negotiation process and the level of customization that each client requires. In the services industry, there are not necessarily price increases due to distance as may be the case when a physical product must be shipped or direct investment in assets within the target market is a factor. The objectives of a firm as well as market conditions have greatly affected prior pricing decisions. This case depicts a firm using, in certain initial phases of a particular market entry, a market-differentiated price-setting strategy based on client-specific demand and potential rather than actual cost of the sales process, establishment of operations and project management. This can imply different foreign and domestic pricing. Further expansion may become detrimental if the different platforms on which processing takes place are not managed properly and either cause reduced economies of scale or data processing issues. The inflows and outflows illustrated in table 10 provide a general notion of what expansion and maintenance has entailed in terms of costs and cash flows.

- 3. Using the internet, explore the global reach of various credit card processors such as TSYS, Certegy, First Data, Nova, Global Payments, and Capital One and bankcard associations such as Master and Visa. What does the future for the outsourcing for bankcard processing portend? Consult the article: Simpson , Burney .(2004) A Powerful Group Of Processors. *Credit Card Management*. 17 (8), 30-35.**

The bankcard processors continue to be greatly influenced by the merger and acquisition activity of the larger banks of the world. In many cases, this activity has resulted in changes in vendors for the processing service. There is presently a trend towards consolidation of the market share among the major processors. The problem for some processing firms, however, is the overall pieces of the pie are becoming larger as the banking industry consolidates under fewer and fewer roofs. Consider the merger and acquisition activities of JP Morgan Chase as well as Bank of America and Fleet Bank. Such consolidation among large banking corporations with sizeable bankcard portfolios implies that in the near future there will be some processing firms with greatly reduced market share and possibly some acquisitions or takeovers of the weakened firms.

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AMERICAN RED CROSS: UNDER FIRE

Johanna Hunsaker, University of San Diego

CASE DESCRIPTION

This case is directed towards undergraduates and graduate students in management classes and classes in non-profit organizations. Depending on the focus of the class, different case questions can be emphasized for students in management classes, leadership classes and those enrolled in non-profit classes.

CASE SYNOPSIS

The case deals primarily with the governance of the San Diego Imperial County Chapter of the American Red Cross in the early part of this decade during, after the debilitating Viejas fire. The chapter's CEO, Dodie Rotherham, seemingly cared more for raising donations to better the chapter than caring for the people in need and the community. Rotherham ignored the internal conflicts of the organization preferring to be out in the public to raise donations. She lost sight of the principal core values of the organization; provide relief to victims and help people prevent, prepare for and respond to emergencies. Because Rotherham and the organization lost touch with the community, the community rose up against the organization when it was discovered that the organization used the donations for the fire victims inappropriately. The organization had to change to survive. The key to its survival was the rebuilding of the trust of the community by removing all of the leaders (CEO and Board of Directors) and developing an organizational culture change that promoted openness, change and development.

The purpose of this case is to demonstrate the effects of leadership on a non-profit organization. Discussion of this case brings about the understanding of the problems that can arise when leadership abandons the organization's mission and goals. Students will have a better understanding of what can happen if management loses focus of the organization's goals and mission. Additionally, students will see that it is difficult to regain the confidence of community when the organization loses touch with the community. The student will learn the espoused values of the Red Cross, the values under Dodie Rotherham, and after Rotherham left the Red Cross, the values Jerry Sanders and Ronne Froman attempted to bring to the organization.

INSTRUCTORS' NOTES

Teaching Objectives

The purpose of this case is to demonstrate the effects of leadership on a non-profit organization. Discussion of this case brings about the understanding of the problems that can arise when leadership abandons the organization's mission and goals. Students will have a better understanding of what can happen if management loses focus of the organization's goals and mission. Additionally, students will see that it is difficult to regain the confidence of community when the organization loses touch with the community. The student will learn the espoused values of the Red Cross, the values under Dodie Rotherham, and after Rotherham left the Red Cross, the values Jerry Sanders and Ronne Froman attempted to bring to the organization.

Audience

This case is directed towards undergraduates and graduate students in management classes and classes in non-profit organizations. Depending on the focus of the class, different case questions can be emphasized for students in management classes, leadership classes and those enrolled in non-profit classes. I believe that all questions can be addressed by these areas, but if you wish to specialize the questions listed below may be more relevant to certain areas.

Principles of Management:	questions # 1, 2, 3 and 8
Leadership:	questions # 2, 4, 6, 7 and 9
NFP:	questions # 1, 2, 3, 4, 5, 8 and 9.

Associated Readings and Material

The values in which the San Diego/Imperial Chapter of the Red Cross taken directly off the chapter's website (www.sdarc.org) are listed below:

- ◆ *Humanitarianism* - We exist in order to serve others in need, independently and without discrimination, providing relief for victims of disasters and helping people prevent, prepare for, and respond to emergencies.
- ◆ *Stewardship* - We act responsibly, effectively, and efficiently with resources entrusted to us, always seeking to improve.
- ◆ *Helping Others* - We are attentive and responsive to those we serve, always listening to their needs and looking for ways to serve through existing or new initiatives.
- ◆ *Respect* - We acknowledge, respect, and support the rights and diversity of each person in our organization and in the communities we serve.

- ◆ *Voluntary Spirit* - We, as a family of donors, volunteers, and staff, search for ways to provide hope to those we serve, while demonstrating compassion, generosity, and appreciation.
- ◆ *Continuous Learning* - We seek, collectively and individually, to identify, obtain, and maintain competencies and the awareness required for exceptional service.
- ◆ *Integrity* - We act with honesty, demonstrate courage and accountability under pressure and openly share ideas and information with each other.

Assignment Questions

Blanchard (2004) lists the following requirements for an organization to be successful in the article “Managing for Values”:

- Identify Core Values
- Communicate Core Values
- Align Values and Practices

1. When you think about the Red Cross, what values do you think they should identify with?

- ◆ To help people
- ◆ Be accountable
- ◆ Open book
- ◆ Providing relief for victims of disasters
- ◆ Help people prevent, prepare for, and respond to emergencies.

2. What were the values the local Red Cross adhered to under Dodie Rotherham?

The values of the chapter under the Rotherham administration were:

- ◆ The local chapter was a reflection of the inconsistencies, poor oversight and arrogance of large entity.
- ◆ Focused primarily on moving the organization ahead by raising large amounts of money in place of serving people
- ◆ Took care of the organization first (purchase of new vehicles for the chapter versus paying out only \$7,000 to victims of the Viejas fire).
- ◆ Lack of respect for employees
- ◆ Lack of integrity (Fraud in Transportation Division)
- ◆ Privacy of Actions
- ◆ No accountability

Over the years, Dodie Rotherham had lost sight of the core values of the Red Cross. She became fixated on raising donations and having the San Diego/Imperial Chapter as the best fund raising chapter in California. In addition, she lost control of the organization. There was tension between the disaster relief and blood business components. Further trouble plagued the organization when it was revealed that the San Diego chapter was under investigation by the State Attorney General for potential fraud in the transportation services sector.

3. What are the effects of misalignment of stated core values of the organization by management?

- A. Donations dropped way down – Required emergency loan
- B. Public became angry
- C. Resignation of the chairman of the board
- D. Firing of Rotherham
- E. Change of the board of directors

At the local San Diego chapter of the Red Cross, the interests of a “few” began to take precedence over the goals and the mission of the Red Cross. Rotherham was so focused on moving the organization ahead by raising large amounts of money. She used the money from the Viejas fire victim’s fund to purchase new vehicles and communications equipment. She looked at taking care of the organization more than the victims. Volunteers and staff were discouraged because of the mishandling of donations and the apparent cover-ups that resulted.

4. What political mistakes do you think Rotherham made?

After 19 years as the CEO of the San Diego chapter, Rotherham had created a large power base for herself. She cultivated a Board of Directors that did not question her decisions or her actions. Rotherham failed to correctly read the political environment around her. She misjudged the level of anger and mistrust in the community and did not position herself well with the media of Supervisor Jacob, who banded their power together to bring her down.

5. What mistakes did the San Diego Red Cross Board of Directors make?

The local San Diego Board of Directors did not fulfill their duties as board members, and can be accused of “being asleep at the switch.” Although it is true that the character of

most nonprofit organizations is set by the chief executive, this board did not adequately evaluate Rotherham or provide policy making input, the board did not ensure that the provisions of the organization's charter was being followed. The board was not involved in the boundaries of the fiscal policy.

6. What values did Sanders and Froman bring to the Chapter after Rotherham left the organization? How did this change help the leadership transition and begin to restore credibility to the Red Cross?

Integrity, openness, cooperation and realignment of the organization to help people Sanders places ads to regain trust of the public by restating the chapter's mission and services New board of Directors to continue the investigations of the fraud and misappropriate of the funds Hired Froman to demonstrate to the community that integrity of the CEO was important to the Red Cross organization Froman was a friend of the national Red Cross CEO Sanders opens the local chapter's books to demonstrate the donations incoming and expenses Swinger (2004) in the article "The Perils of Doing the Right Thing" warns management that they must do the right thing for the organization and the customer. The four lessons for the manager to take into account are:

- Lesson 1: Make sure what you are doing is really leadership and not just self-adulation.
- Lesson 2: Be prepared to be attacked by virtue of your virtue
- Lesson 3: Expect to have your motives questioned and your leadership credentials challenged
- Lesson 4: Circumstances beyond your control – including public hysteria – can undermine your position

7. Was Dodie Rotherham a good leader or was she promoting herself and her agenda?

Dodie Rotherham was not a good leader. There was in-fighting between units and fraud in the transportation division. She took pride in the accomplishment of the organization to raise money and loved to be around politicians and the wealthy. At the local San Diego chapter of the Red Cross, the interests of a "few" took precedence over the stated goals and mission of the Red Cross. Rotherham was focused on moving the organization ahead by raising large amounts of money. Rotherham enjoyed the recognition of being the CEO of the number one money raising chapter in California and did not wish to relinquish her power. She clung to power in front of growing community hysteria for her actions in regard to the Viejas fire. Part of the clinging to power included the cover up of the national

audit of the donations and expenses of the Viejas fire, alteration of the results to suit her position, and denial that she did nothing wrong.

8. What was the result of the improper use of donations that were received from the community for the Viejas fire victims?

- Community hysteria brought on by the actions of Supervisor Diane Jacobs
- Donations Dropped - Emergency Loan Required to Meet Expenses
- Chairman of the Board, Duddles, resigned
- Rotherham was fired
- Entire remaining members of the board removed
- New Chairman, Jerry Sanders appointed
- New CEO, Ronne Froman was hired

9. What will the first task of Sanders be to bring back the confidence of the community?

The first task for Jerry Sanders was to gain the confidence of the community and the national Red Cross management. Blanchard (2004) reminds us that the organization to be successful must align its practices with its values. The hiring of a new board and responsibility and was there to serve them Ronne Froman serves as Chief Executive. Froman joined the American Red Cross in 2003 and through her leadership quickly and decisively developed. "The New American Red Cross in San Diego" by refocusing the organization on its core mission of disaster relief and emergency preparedness. Froman is a retired Navy Rear Admiral and the former "Navy Mayor of San Diego". She brings a wealth of knowledge and experience to the American Red Cross of San Diego and Imperial Counties, with over 31 years of service as Naval Officer leading similar reform efforts.

Her expertise is reorganizing, saving money and improving services. Froman is a no-nonsense "efficiency expert" and whether she's helping the military, education or human service organizations, Froman is always ready to meet any challenge head-on. Froman has received the Defense Distinguished Service Medal, Navy Distinguished Service Medal (two awards), and various service and unit awards.

Teaching Plan

The teaching plan for this course is to inform the students of the case and to have the students understand that an organization must adhere to its stated goals and values. Without alignment of the organization to its known goals and values, the organization will lose touch on why it is

inexistence and drift down a different path. When the organization undergoes a stressful event, there is chance that the organization will fail.

Discussion should be centered on the leadership of the organization by Rotherham followed by a discussion of the values that the Red Cross is known for and what the community saw during the aftermath of the Viejas fire. After the discussion of the values of the organization has been completed, a review of what Sanders and the national Red Cross did to right the organization should be undertaken. The professor should enhance the discussion by asking the following discussion questions.

Handouts should be used to direct the students towards learning of how important it is that the organization must maintain its image and stick to its core values.

The handouts for the class are:

1. Web page of the San Diego Chapter describing its core values (www.sdarc.org) (Attachment one)
2. Timeline of events (Attachment Two)
3. Values summary of the case (Attachment Three)
4. What is going on at the Chapter now (Attachment Four)

ATTACHMENT 1



SAN DIEGO/IMPERIAL COUNTIES AMERICAN RED CROSS

Values

Affirming our commitment to the Fundamental Principles of the international Red Cross and Red Crescent Movement, we pledge ourselves to these values:

Humanitarianism

We exist in order to serve others in need, independently and without discrimination, providing relief for victims of disasters and helping people prevent, prepare for, and respond to emergencies.

Stewardship

We act responsibly, effectively, and efficiently with resources entrusted to us, always seeking to improve.

Helping Others

We are attentive and responsive to those we serve, always listening to their needs and looking for ways to serve through existing or new initiatives.

Respect

We acknowledge, respect, and support the rights and diversity of each person in our organization and in the communities we serve.

Voluntary Spirit

We, as a family of donors, volunteers, and staff, search for ways to provide hope to those we serve, while demonstrating compassion, generosity, and appreciation.

Continuous Learning

We seek, collectively and individually, to identify, obtain, and maintain competencies and the awareness required for exceptional service.

Integrity

We act with honesty, demonstrate courage and accountability under pressure and openly share ideas and information with each other.

ATTACHMENT 2



Time Line of Events	
1898	San Diego Red Cross Chapter Formed
1957	First mass anti-polio occultation
1978	Helped out with the PSA Crash
1983	San Diego and Imperial County Red Cross Chapter Merges
	Rotherham becomes CEO
1/3/2001	Viejas Fire
1/30/2001	Diana Jacobs requests contributions in San Diego County be spent in Alpine
5/2001	Jacobs receives report on use of funds. She is not satisfied with the report and asks assistance from the National President of the Red Cross
8/2001	Rotherham defends handling of the situation. Produces accounting for some of the money spent on the Viejas fire relief.
9/2001	National office assured Jacob that an audit would be conducted
10/2001	National Red Cross President Fired
11/2001	Local SD media obtains copy of the national audit
	Chairman of the local office, Duddles, apologies for the organization's handling and solicitation of funds during the Viejas Fire
4/2002	Oversight committee formed
	Committee Recommends Duddles to Step down
5/2002	Committee Recommends Rotherham to retire or be fired
6/2002	Volunteer Directors Removed from SD Chapter
7/2002	Jerry Sanders Appointed Chairman of the board
	Veronica "Ronne" Froman becomes CEO
10/2003	New Wild Fires in SD

ATTACHMENT 3

VALUES IMPORTANT TO THE CASE

Core Values of the Red Cross

Humanitarianism
Stewardship
Helping others
Respect and Integrity

Values of the San Diego Chapter (Under Rotherham)

The local chapter was a reflection of the inconsistencies, poor oversight and arrogance of large entity. The chapter had lost focus on its core Red Cross programs and was more interested in making money than serving people. Chapter focused primarily on moving the organization ahead by raising large amount of money. San Diego/Imperial County Chapter raised more money than any other chapter in California (ahead of Los Angeles Chapter).

Rotherham took care of the organization (purchase of new vehicles for the chapter versus paying out only \$7,000 to victims of the Viejas fire. Employees that spoke up about fraud and misappropriation of funds let go. Militarization – Top down management organization – Power from above Few commonly understood performance measures was used in the organization No system of reward or consequences for employee behavior and performance In fighting and power struggles (chase of the money) – There was tension between the disaster relief and blood businesses

Values of San Diego (Sanders)

Places ads to regain trust of the public by restating the chapter's mission and services New board of Directors to continue the investigations of the fraud and misappropriate of the funds Hired Froman to demonstrate to the community that integrity of the CEO was important to the Red Cross organization

ATTACHMENT 4**SAN DIEGO/IMPERIAL COUNTIES AMERICAN RED CROSS****What's Going On At Our Chapter Now?**

- Veronica "Ronne" Froman has been selected as Chief Executive Officer of the San Diego/Imperial Counties Chapter. Froman comes to the American Red Cross from the San Diego Unified School District, where she has served as Chief of Business Operations. As the CBO, she has been responsible for the modernization and automation of the district's finance, technology and logistics support operations and infrastructure. Froman will apply a wealth of knowledge and experience to the San Diego/Imperial Counties American Red Cross, having previously spent over 31 years serving her country as a Naval Officer leading similar reform efforts around the globe, retiring with the rank of Rear Admiral. She is a recognized leader in change management and business modernization and automation.
- Sixteen distinguished business and community leaders were installed as the Chapter's Board of Directors in December 2002. Former San Diego Police Chief Jerry Sanders was elected Board Chairman for 2002-2003.
- Disaster Action Teams have responded to over 250 disasters in San Diego and Imperial Counties since July 1, 2002.
- The "Together We Prepare" disaster preparedness campaign was launched to help San Diegans and Valleyites be prepared in the event of a natural or man-made disaster.
- A record 2,317 people learned CPR in just one day at the 2002 "CPR Saturday" event held at the San Diego Concourse. San Diego's CPR Saturday is the largest single CPR training event in the United States.

SAN DIEGO/IMPERIAL COUNTIES AMERICAN RED CROSS

- The Chapter's Armed Forces Emergency Services call center continues to process a record number of emergency messages for military families due to the conflict in Iraq. Over 13,000 calls per month pour into the call center from around the world, up from a monthly average of 4,000 prior to accelerated deployments.
- The State of California honored the Red Cross Women, Infants, and Children (WIC) Program with several awards for 2002, including Exceptional Breast-feeding Promotion and Support and Innovative Staff and Career Development.
- Reviews of every line of service within the Chapter were released to the media and the public.
- Twenty individuals in 12 categories were honored for lifesaving acts at the Chapter's first "Real Heroes" Breakfast on May 1, 2003.

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KMART-SEARS MERGER OF 2005

Noushi Rahman, Pace University
Alan B. Eisner, Pace University

CASE DESCRIPTION

The primary subject matter of this case is corporate strategy. The subject matter is fleshed out in the context of a merger. This case is intended for an undergraduate or graduate corporate strategy section of a business strategy course. The case is designed to be taught in one class hour and is expected to require one hour of outside preparation by students.

CASE SYNOPSIS

In November 2004, retail giants Kmart and Sears announced plans to “merge” their operations. The “merger” was finalized in March 2005 and the combined entity was named Sears Holding Company. At the completion of the “merger,” Sears Holding Company had revenues of more than \$55 billion (in addition to \$2.8 billion in debt), making it the third largest domestic retail company following Wal-Mart and Home Depot. The new organization would face three important issues: competition, synergy, and culture. Appropriate strategies, structures, and culture-blending initiatives must be developed to integrate these historic, disparate organizations to successfully perform as one unified business firm.

INSTRUCTORS' NOTES

Teaching Objective

This case is intended for use in a business policy and strategy class. In terms of its length, writing style and content, the case should be relatively facile for any undergraduate senior to read and comprehend. The authors wrote the case in a style that overviews the situation but intentionally avoids guiding students through specific application questions or any analytical framework. Subject style enables the instructor to adjust class discussion to accommodate students with a broad range of abilities. Specifically, instructors can invite more experienced students, including graduate students, to reason through a situation where uncertainty exists and speculation may be required.

Case Use

Course: Business Policy and Strategy (Undergraduate or Graduate)

Suggested Position in Course: Corporate Strategy Case

The case can be targeted as a corporate strategy case; helping students to understand the various issues associated with strategic change. After completing this case, students should recognize an impetus for changing a corporate strategy – including why firms choose to find partners for mergers and other strategic moves to adapt to changes in the industry environment, how firms identify the necessity to change their corporate strategy, and how they implement change.

The case of the Kmart/Sears merger illustrates two retail giants “merging” to reposition themselves in response to competition in the retail environment (Textbook Chapter: Corporate Strategy), declining profits related to lack of internal growth issues at each respective organization (Exhibits 1 and 2), and historical problems with brand identity. Kmart and Sears have joined forces to create a global retail giant to better compete with market discount leader Wal-Mart and other leading mass merchandisers such as Target. The fate of the individual brands that made both Sears and Kmart popular—Martha Stewart, Jacyln Smith, Lands End, Kenmore, Die Hard, Craftsman, etc.—are still to be determined. However, the Sears name will live on and the Kmart name will likely fade away. This will be important in terms of brand identity and customer loyalty.

Of interest, opinion polls and analysts clearly point to a more positive connotation with the Sears name than the Kmart name, justifying the new entity’s name: Sears Holding Company (SHC). It should be noted that the Sears name is more popular with male consumers than female consumers based on the strength of their tools, equipment, automotive and home improvement lines. Both Sears and Kmart have never been viewed as fashion-forward entities by female shoppers. Of greater interest, however, is that while Kmart was more financially stable than Sears pre-merger (i.e., Kmart had less shares outstanding, higher earnings-per-share, higher stock prices, lower long term debt, less liabilities, higher return on equity, higher return on assets, higher return on investments, higher net profit margins, and lower debt-to-capital ratios), Kmart continued to be viewed as a “damaged” brand name in consumer polls. The question remains whether the Sears name will exist in the traditional, familiar way (i.e., well stocked inventories and trained quality sales staff with “in-department” expertise) or as something else, such as a hybrid appliance/home center giant combined with a discounter, pharmacy, grocery, and retail components (Textbook Chapter/Section: Corporate Parenting and Restructuring). In order for the new entity to be successful, the following critical issues need to be addressed:

1. What is the Sears Holding Company and what does it want to become?
2. What is its brand identity?
3. Who are its customers?
4. What are its competition: (a) Home Depot, the second largest U.S. retailer, based on the strength of Sears tools and outdoor equipment sales?; (b) Wal-Mart, the largest U.S. retailer, best known as a discount retailer offering conventional apparel and the market leader in grocery/food sales?; or (c) Target, now the fourth largest U.S. retailer following SHC, that is popular among younger consumers and known for discount hip apparel and home furnishing brands?
5. How does it plan to combine two disparate cultures with strong ties to American history, into one uniform culture that looks to the future, not to the past?
6. What are its specific plans to create synergy among the former Sears and Kmart operations and systems? For example, the disparity ranging from the product lines and staff expertise of the exclusive Sears appliance, tool, automotive, equipment, and home improvement lines to the Kmart pharmacy expertise and grocery retail experience?

SYNOPSIS

In November 2004, retail giants Kmart and Sears announced plans to “merge” their operations. The “merger” was finalized in March 2005 and the combined entity was named Sears Holding Company. At the completion of the “merger,” Sears Holding Company had revenues of more than \$55 billion (in addition to \$2.8 billion in debt), making it the third largest domestic retail company following Wal-Mart and Home Depot. The new organization would face three important issues: competition, synergy, and culture. Appropriate strategies, structures, and culture-blending initiatives must be developed to integrate these historic, disparate organizations to successfully perform as one unified business firm.

SHC’s Long-Term Business Strategy

The new entity has announced its long-term strategy as:

1. Expanding upon the Sears Grand concept (off-mall stores which carry consumables) to counter the “loss of consumers to savvier rivals” by benefiting from Kmart’s

- experience in the consumables and apparel markets. Consumables are viewed by the SHC as “traffic builders”;
2. Expanding the Sears Essentials model stores (smaller—80,000 square feet—convenience-driven stores which can be developed off-mall rapidly by converting existing Kmart locations that are located in key urban and high-density suburban markets with customer demographics and income levels matching those of the typical Sears shopper). These stores are on a single level, offer a variety of products and feature exit cashiering, a centralized customer service center (similar to the layout of Sears Grand stores) and generate foot traffic through the sales of consumables and pharmacy/health and beauty aides;
 3. Converting Kmart stores to the Sears name in “markets where existing Kmart stores better fit Sears’ demographic of slightly higher-income shopper’s;
 4. Cross selling by having Kmart carry Sears’ lines such as Kenmore appliances, Craftsman tools, and diehard batteries;
 5. Switching stores between chains and selling stores due to the huge real estate portfolio of SHC (although this can be limited by mall owners—74% of mall owners followed by Merrill Lynch contain a Sears store); and
 6. “Emphasizing apparel labels that appeal to a multicultural audience (Latinos and African Americans make up a significant share of Sears’ shoppers and comprise a natural audience at Kmart’s many inner city locations).”

Although the management of SHC has created twelve separate merger teams to assist in the transition (“employees resisting change may make implementing a strategic change difficult or impossible” [Levin, 1952]), the following issues remain unclear:

- a. how the new entity plans to manage and communicate change to employees, managers, independent operators affiliated with Sears and Kmart, suppliers, etc. and manage any resistance to change;
- b. what corporate identity or “image” will be associated with SHC (both Sears and Kmart have been historically accused of having a lack of vision and in delivering inconsistent messages which culminated in the frequent changing of business strategies--“four out of five companies that have attempted to change business strategies have failed to meet the new strategy’s objectives” [Porter, 1996]);
- c. how SHC plans to build its customer base and consumer loyalty (this relates back to (b) above and in knowing what kind of a company it is, what it wants to be, what its competition is, what its strengths and weaknesses are; these problems have plagued both Sears and Kmart in recent decades);

-
- d. whether the long term strategy proposed by SHC is specific and consistent enough to marry the distinct retail entities and their unique cultures to create the synergy to successfully compete in the retail sector.

TEACHING PLANS

Given the decision to “merge” Sears and Kmart and create new store formats to compete with Wal-Mart and other big box retailers, ask students to discuss the strategic issues outlined by the new Sears Holding Company. Does the strategy proposed—the Sears Grand and Sears Essential stores, and conversion of Kmart stores to Sears in certain demographic locations—adequately address the real competitive edge currently enjoyed by world leader Wal-Mart and by hip, chic Target (Textbook Chapter: Organizational Structure)? Does the SHC corporate strategy adequately address the strengths and weaknesses of the individual brands and product lines of the former Sears and Kmart and go far enough to specifically address the issue of product complementarity and staff training? Does the corporate strategy specifically outline the human resource impact and plans to manage change and synergize operations, systems and staff (Textbook Chapter: Organizational Control)?

We believe that this case provides a rich context to discuss Environmental Analysis and Internal Analysis of the former Sears and Kmart organizations, and Corporate-level strategic analysis for the new Sears Holding Company. In terms of Environmental Analysis (Textbook Chapter: External Analysis), aspects of this case analysis relate directly to Porter’s Five Forces as regards the strategy selected to pursue an advantage over rivals (geographic expansion and store format changes), and in terms of the exploitation of relationships with suppliers (big box control over suppliers). Also key is what generic strategies (cost leadership, differentiation, and focus) SHC plans to use to counter the Five Forces (Textbook Chapter: Competitive Strategy). As regards Internal Analysis, this case presents an interesting example of the complementarity of the individual store brands and product lines, suppliers and business lines and the importance of creating a new, single culture that is forward-driven (Textbook Chapter: Internal Analysis). With respect to corporate-level strategic analysis, the merger move was a vehicle to pursue quick horizontal integration (Textbook Chapter: Corporate Strategy). Both firms were motivated to merge because both were losing market share. However, gaining market share through a merger is clearly not the solution to losing market share. The merged firm must take advantages of synergies of combining various products, economies of scale for producing more of the same thing, and economies of scope for producing more of different things. Also, a great deal of learning curve benefits can occur if Sears and Kmart actively learn the best practices of each other. Nevertheless, mergers tend to face one huge obstacle of blending disparate corporate cultures and corporate strategy analysis ought to address this issue as well.

ASSIGNMENT QUESTIONS

As noted in the “teaching objectives” section, the opportunity exists in this case to engage in speculation. The authors of this case believe that better students will respond to this uncertainty and see an opportunity to exercise their ability to reason logically in the face of uncertainty and fierce competition. The questions presented below cannot be fully answered without some degree of speculation. For each question below, we offer an average response by a student. Each instructor using this case is encouraged to do the analysis as well.

1. Was the decision to merge K-mart and Sears a good strategic move in order to compete with discount retailer and cost/market leader Wal-Mart and to increase market share?

Both Sears and Kmart had experienced growth and revenue problems in the years immediately preceding the merger. The decision to merge creates additional retail locations for “quick” growth by virtue of store conversions to the Sears name format, which SHC’s management believe will result in an increase in market share. Through the cross-selling of previously successful brands and product lines in the new store formats, and coupled with the creation of new selling regions and districts, and the entry of Kmart into inner city neighborhoods, SHC hopes to capitalize on the successful brands of the former Sears and Kmart entities, e.g., Kenmore, Craftsman, DieHard, Martha Stewart, etc. and gain a better footing in the minority market.

However, the current lack of a clear management plan and focus on the cross-training of Kmart employees and management on specialized lines (e.g., Sears automotive, tools, outdoor equipment, house windows/siding, appliances, etc.), a forte of the Sears floor selling model, can only lead to a further erosion of customer loyalty and consumer dissatisfaction with in-store selling experiences and in service. The SHC corporate strategy focuses intensely on plant and expansion issues (increased geographic locations, changes in store formats, conversion to the Sears nameplate, plans to increase store foot traffic and growth in off-mall locations) but does not adequately address human capital and management issues.

2. According to analysts, building a brand image is key to the success of the Sears Holding Company. Why is it important for the Sears Holding Company to establish brand identity sufficient to create a distinct retail experience?

Identifying a brand image is critical to positioning the Sears Holding Company in the market and to consumers. In other words, it needs to be very clear as to whether SHC is a retail discounter like Kmart and Wal-Mart or more like Home Depot with strengths in tools, appliances, outdoor equipment, and home repair. Or, does it aspire to be both or neither?

If SHC plans to stick to its mass merchandising, it is important to decide what kind of products will SHC stores carry (i.e., generic, super-value items like Wal-Mart does or chic, premium items like Target does). An ill-defined brand image will hinder the success of the Sears Holding Company, creating confusion among shareholders (as exemplified by the former Kmart in the 1990s), employees, managers, and consumers. Particularly with regards to consumers, when they do not know whether the store will sell expensive premium items or discounted generic items, they will most likely start avoiding the store altogether. Ultimately, this would result in a loss of existing customers loyal to the former Sears and/or Kmart, and prevent SHC from gaining much-needed market share (it may even cause a loss of overall market share).

3. Is the corporate-level strategic move to create geographic regions and districts with Sears Grand and Sears Essential stores, through the conversion of existing real estate, enough to build market share and customer loyalty? Are the strategic plans outlined by management immediately post-merger sufficiently specific and targeted to accomplish this goal?

The strategic moves outlined by the Sears Holding Company address some of these issues, but are not specific or focused enough to attack the major challenges of growth by expansion, geographic territory, minority appeal, and store formats. This kind of grouping is common among smaller retailers (since they often operate in a narrow market). As a large retailer, SHC would be able to compete with these specialized retail stores through its various geographic regions and districts (and with different store formats). Also, the Sears name, which is near and dear to the hearts of small town America and popular with males based on recent opinion polls, could represent a significant positioning opportunity (regarding home improvement and auto related products) if properly exploited and executed. Moreover, distinct store formats would allow SHC to deliberately group its product offerings. Consequently, Sears Grand stores could opt to develop a brand image that is very different from Sears Essential stores.

4. How are cultures of the two companies different? How can SHC blend the two corporate cultures to positively influence the synergy creation process?

Sears' culture is more innovative than Kmart's. Sears stores also offer a more sophisticated environment than Kmart stores. Within a unified culture, employees who are used to any one type of culture will feel out of place. Customers who valued the sophisticated environments of Sears would expect the same in SHC, any less will not do. Conversely, customers who did not care for the shopping environment of the stores (as long as the

bargains were the best in town), would care little for the extra effort SHC might put in to offer its customers an improved shopping experience. Bringing these seemingly different cultures would require extra efforts by dedicated taskforce at the corporate level and managerial staff at the store level to orchestrate a seamless integration. Hence, as problems would arise, these staff would be able to address them on the spot and sketch out long-term solutions at the corporate level. Moreover, a culture of one-ness could be fostered by store-wide events, and celebration of successful integration and milestone achievements at newly merged stores.

A two pronged marketing campaign might be necessary too. First, in areas where more Kmart shoppers live, SHC needs to convince the customers that there is a lot more in life than bargain basement prices. Second, in areas where more Sears shoppers live, SHC needs to advertise its added features in its merged stores and the probability of potential bargains in its products. SHC needs to also send the message that the newly merged stores will not compromise with the sophisticated culture of the “old Sears” stores.

EPILOGUE

Only by creating a distinct and clearly communicated brand image, and by implementing a successful change management strategy focused on the education and development of human resource capital, can the Sears Holding Company hope to successfully unite the Sears and Kmart cultures and become forward-thinking. Due to the “newness” of the merger, there is insufficient data to further develop this.

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